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April 30, 2013

By Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Regulation YY: Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies; Docket No. 1438 and RIN 7100-AD-86

Ladies and Gentlemen:

The Institute of International Bankers (the “IIB”) appreciates the opportunity to comment on the proposed regulations published by the Board of Governors of the Federal Reserve System (the “Board”) to implement Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act” or “Dodd-Frank”)¹ for foreign banking organizations.²

The IIB represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. The IIB’s members consist principally of FBOs that conduct banking operations in the United States through branches and agencies and bank subsidiaries, and nonbanking operations through subsidiaries such as commercial lending firms, broker-dealers, investment advisers and insurance companies.

In the aggregate, our members’ U.S. operations have approximately \$5 trillion in assets, fund 25% of all commercial and industrial bank loans made in this country and contribute to the depth and liquidity of U.S. financial markets. U.S. broker-dealer subsidiaries of foreign banks account for nearly one-third of all U.S. dollar denominated securities underwriting. Our

¹ Codified as 12 U.S.C. §§ 5365 and 5366.

² Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76,628 (Dec. 28, 2012) (the “Proposal”). For ease of reference we refer to the foreign banking organizations covered by the Proposal as “FBOs”, a U.S. branch or agency of an FBO as a “U.S. branch”, and all the U.S. branches and agencies of an FBO collectively as its “U.S. branches” or “U.S. branch network”, unless the context requires otherwise. We also refer to Sections 165 and 166 of Dodd-Frank collectively as “Section 165” and the heightened prudential standards contemplated in Sections 165 and 166 of Dodd-Frank as the “Section 165 Standards”.



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members also contribute more than \$50 billion each year to the economies of major cities across the country in the form of investments, employee compensation, contributions to local and national charities, tax payments to local, state and federal authorities, and other operating and capital expenditures. As the Board notes in its Proposal, the presence of FBOs in the United States “has brought competitive and countercyclical benefits to U.S. markets.”³

Introduction

The IIB strongly supports enhancing U.S. and global financial stability through robust supervision and regulation—including the appropriate implementation of Section 165. We commend the continuing efforts of the Board and other U.S. and non-U.S. supervisors to harmonize and coordinate the development and implementation of the many fundamental reforms currently underway, including reforms developed through the Financial Stability Board (the “FSB”) and the Basel Committee on Banking Supervision (the “Basel Committee”). We also appreciate and understand the Board’s focus on potential threats to U.S. financial stability emanating from the operations of globally active systemically important financial institutions (“SIFIs”) headquartered in other jurisdictions. As the international framework for systemic risk regulation continues to evolve, it is apparent that enhanced and forward-looking capital and liquidity standards, recovery and resolution planning and other supervisory tools applied through internationally coordinated measures will be key to the effort to preserve financial stability in the United States and abroad.

At the same time, the financial services industry and the supervisory community are faced with the task of balancing the development of enhanced bank supervisory standards against the priority of promoting U.S. and global economic recovery. It is our shared hope that the economic historians of the future do not judge the U.S. and global regulatory response to the U.S. financial crisis as a reaction that impaired global economic development. And we therefore strongly support a U.S. policy commitment to developing U.S. regulations under Dodd-Frank in an internationally coordinated fashion that achieve the common objective of preserving U.S. and global financial stability and, at the same time, promoting U.S. and global economic recovery.

Implementation of Section 165 presents a challenge for the Board from the perspective of avoiding unintended consequences for financial stability and economic growth. Measures designed to address potential future risks and scenarios based on the “lessons learned” during the previous crisis present a special challenge in this respect, as they risk creating new, as yet unidentified vulnerabilities and interdependencies that could prove to be destabilizing in the next crisis, or to increase (rather than decrease) the need for extraordinary government assistance

³ 77 Fed. Reg. at 76,629.



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to banking organizations, or to create the need for regulators to interpret around previously adopted laws and regulations. Some unintended consequences may not become apparent until long after new rules are put into place. Meeting this challenge, in light of the high stakes and delayed effects of many reforms, warrants, we would submit, careful and thorough study to a much greater degree than the usual and customary deliberation over policy choices.

The task of integrating the Board's implementation of Section 165 with the existing framework for supervising and regulating FBOs, together with existing and evolving international agreements and standards, and the evolving home country supervision of cross-border banking organizations, requires the Board to address difficult practical and legal issues.⁴ Section 165 contemplates the application of consolidated heightened prudential standards to SIFIs, and adapting these standards from the context of bank holding companies headquartered in the United States ("U.S. BHCs") to the context of FBOs conducting cross-border banking and nonbanking operations in the United States understandably requires consideration of several interrelated factors.

Chief among these factors is Congress's explicit direction to the Board that it give due regard to the principle of national treatment and equality of competitive opportunity, and take into account the extent to which each FBO to which the Section 165 Standards apply is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.⁵ In addition, Congress required the Board to take into account differences among financial institutions based on their systemic footprints and risk profiles.⁶ Another critical factor is the importance of implementing the Section 165 Standards in a manner that supports the degree of international cooperation and coordination necessary for effective supervision of internationally active banks. Indeed, Congress assigned the Board a statutory responsibility to work towards stronger, more consistent and effective global regulation of SIFIs.⁷

⁴ See Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 597-98 (Jan. 5, 2012) (the "Domestic Proposal" and together with the Proposal, the "Proposals").

⁵ See Dodd-Frank § 165(b)(2) ("[T]he Board of Governors shall . . . take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.") (emphasis added).

⁶ See Dodd-Frank § 165(b)(3).

⁷ See Dodd-Frank § 175(c) ("The Board . . . and the Secretary [of the Treasury] shall consult with their foreign counterparts and through appropriate multilateral organizations to encourage comprehensive and robust prudential supervision and regulation for all highly leveraged and interconnected financial companies.").



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Executive Summary of the IIB's Principal Comments

We have several fundamental concerns regarding the Proposal and its implications for cross-border banking. Our concerns range from potential macroeconomic effects in the United States and abroad and implications for the stability and competitiveness of U.S. financial markets, to inconsistencies with the Board's statutory mandate and authority in Dodd-Frank, to specific concerns regarding how the Proposal's requirements would operate in practice and their implications for FBOs that provide cross-border financial services to U.S. customers.

Depending on how they are designed, application of the Section 165 Standards to FBOs could have profound and long-lasting effects on the conduct of cross-border banking in the United States. We are concerned that some elements of the current Proposal would be effectively irreversible once put into effect, in light of the high sunk costs that would be required for FBOs to come into compliance. Given the high stakes and critical importance of the issues involved, the Board's implementation of Section 165 Standards should be undertaken cautiously, with due deliberation and careful study. A gradual, incremental approach to implementation would also be of great benefit to identifying and understanding potential unintended consequences of any chosen approach, and would facilitate understanding and coordination between U.S. and global authorities regarding joint supervisory expectations.

Based on the Board's discussion of the Proposal in the preamble to the proposed rule, it appears to us that the Board has not yet conducted sufficient economic analysis of the Proposal's potential direct and indirect effects or analysis of the relative costs and benefits of the Proposal from the perspective of affected institutions, U.S. financial markets or U.S. or global economic recovery. Nor does the Proposal provide a satisfactory explanation of how its categorical approach to systemic risk regulation complies with the Board's statutory mandates in Section 165. In our view, it is imperative that such an analysis be conducted in order to ensure that unintended consequences do not undercut the Proposal's intended benefits. For this reason, we urge the Board to revise the Proposal in a manner consistent with our comments and suggestions and publish a revised proposal for public comment that includes a more complete study of the quantitative and qualitative analysis and conclusions that form the basis of the Board's proposed approach.



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Our primary concerns, discussed in detail in the attached comments, include the following:

- *The Proposal's potential implications for U.S. financial markets and the U.S. and global economic recovery do not appear to have been adequately studied, and the relative costs and benefits of the Proposal have not been explicitly analyzed and publicly addressed.*
 - The central regulatory requirement introduced in the Proposal—requiring more than two dozen FBOs to restructure their U.S. subsidiaries into a new “intermediate holding company” (“IHC”) and imposing localized capital and liquidity requirements on the IHC—would profoundly disrupt the way many of the largest FBOs conduct their U.S. financial services operations. And similar effects could ensue from the localized liquidity requirements that would apply to U.S. branches.
 - In its explanation of the Proposal, the Board appears to assume that such a restructuring of a major portion of the U.S. financial services markets could be accomplished without significant consequences for the competitiveness of U.S. markets, the depth and liquidity of those markets, and the strength of FBOs as providers of credit and other financial products to U.S. customers.
 - In our view, the prospect of localized U.S. capital and liquidity requirements, especially when imposed on newly restructured IHCs, is virtually certain to discourage many FBOs from committing to U.S. financial markets.⁸ Whether some FBOs shrink their U.S. operations or close their U.S. banking operations altogether, the U.S. financial markets, and the broader U.S. economy, would suffer.
 - We have especially serious concerns about the potential impact of the Proposal on U.S. Treasury repo markets, including potential adverse effects on the depth and liquidity of those markets and, ultimately, on the spreads on U.S. Treasury securities and borrowing costs for the U.S. government. FBO-owned primary dealers currently constitute a majority of the primary dealers. The proposal could have the unintended consequence of causing FBO-owned primary dealers to withdraw from the market or scale back their U.S. operations and thereby adversely affect

⁸ See Oliver Wyman, Enhanced Prudential Standards for Foreign Banking Organizations: An Impact Assessment at 23 – 26 (Apr. 30, 2013) (the “[Oliver Wyman Study](#)”) (concluding that one effect of the Proposal will be significant “capacity withdrawal” by FBOs and their subsidiaries from U.S. markets).



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pricing in the U.S. treasury securities repo markets. Indeed, Oliver Wyman has estimated that the proposed IHC requirement could result in a \$330 billion reduction in capacity from the U.S. repo markets, representing over 10% of this market.⁹

- Especially at a time when the U.S. economic recovery remains delicate, and global economic conditions remain uncertain, profound changes to current U.S. supervisory and regulatory practices should be undertaken only with extreme care and after careful study of its implications for cross-border banking and U.S. financial markets.
- This observation becomes even more important in light of the risk that other countries will adopt reciprocal measures in response to the Board's Proposal, with implications for all global banks, including U.S.-headquartered banks conducting business abroad.
- The Board's explanation of the Proposal does not analyze its potential direct and indirect economic effects, nor does it weigh the costs of the Proposal against its intended benefits.
- In our view, the Proposal also does not sufficiently analyze whether *ex ante* barriers to cross-border flows of capital and liquidity could exacerbate financial instability in the United States or abroad (or both), or create increased pressures to provide U.S. governmental liquidity support in a crisis to banks operating in the United States, or drive credit and other financial intermediation services into the unregulated shadow banking system.¹⁰ If the Proposal does any of these things, it will have undercut its main stated objectives.
- *The Proposal contravenes Congress' specific directions regarding the Board's implementation of Section 165 and would have disproportionate effects on FBOs that do not present material risks to U.S. financial stability.*
 - Section 165 contains clear statutory directives that require the Board to:

⁹ See *id.* at 24 – 25.

¹⁰ See *id.* at 26 – 28 (describing how increased concentration, a shift to the shadow banking industry and other systemic risks could ensue).



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- Focus on regulation of systemically important banking organizations at the consolidated level as a starting point for implementation of the Section 165 Standards;
 - Take into account the extent to which each FBO to which the Section 165 Standards apply is subject to comparable standards on a consolidated basis in its home country;
 - Adhere to the principle of national treatment and competitive equality; and
 - Tailor the Section 165 Standards to reflect actual risks to financial stability.
- These directives indicate that Congress intended that the Board expand and elaborate on its current approach to regulation of the U.S. operations of FBOs, rather than create a fundamentally different approach.
 - Although the Proposal defers to comparable home country standards in a few discrete areas for those FBOs with more limited U.S. operations (e.g., consolidated capital standards and home country stress testing), the more significant weight of the Proposal amounts to a rejection of this established approach in favor of one that is contrary to Congressional intent as expressed in Section 165.
 - The Proposal would require FBOs with \$10 billion or more in U.S. non-branch assets to establish an IHC with ring-fenced capital and liquidity requirements regardless of Congress' directive to consider the comparability of the FBO's home country standards applied on a consolidated basis. According to the Board's estimate, 26 FBOs would be required to form IHCs, almost one-third of which would have IHCs with less than \$50 billion in total consolidated assets.
 - The one-size-fits-all approach taken in the Proposal would apply the same IHC requirements to all FBOs above the relevant asset thresholds, without consideration of the strength of their parent or their home country regulatory standards. A hyper-capitalized FBO from a country whose capital standards were stricter than U.S. capital standards would still need to form and separately capitalize a U.S. IHC.



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- The Board's stated justifications for its explicit rejection of approaches that look first to compliance with comparable home country standards—in particular, its concerns regarding its continued ability to rely on parent FBOs to serve as a source of strength for their U.S. operations—do not, in our view, support such a broadly applicable departure from current practice and its statutory mandate.
 - As explained in our attached comments, the Proposal appears to ignore real differences in the financial strength, home country regulation and mix of activities among FBOs, and fails to acknowledge the powerful legal and reputational incentives for parent FBOs and their supervisors to support their U.S. operations.
- Many aspects of the Proposal are inconsistent with the Dodd-Frank Act's requirement to consider the principle of national treatment and competitive equality.
 - Most importantly, the IHC requirement, and the capital and liquidity standards that would attach to an IHC, would be fundamentally inconsistent with national treatment.
 - The Board appears to have taken a narrow view of the national treatment requirement, suggesting that so long as an IHC itself is regulated in a comparable manner to a U.S. BHC, national treatment is achieved. In our view, this ignores certain fundamental differences between an IHC and a U.S. BHC—namely, that IHCs are subsidiaries of a larger, consolidated FBO and would be regulated on a sub-consolidated level, whereas the Domestic Proposal applies Section 165 Standards to U.S. BHCs at their top-tier, globally consolidated parent.
 - The IHC standards would regulate the U.S. operations of an FBO as if they were separate, independent entities, denying the IHC the benefit of its parent's global capital and liquidity support in a way that is not comparable to how U.S.-headquartered banking organizations are regulated both here and abroad. This fundamental divergence from the principle of national treatment presents itself in almost every facet of the Proposal.



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- Even if the IHC were viewed as a stand-alone entity (ignoring the existence of its parent), the Proposal would be inconsistent with national treatment. Among other reasons, it would apply certain heightened standards to IHCs with \$10 billion in assets when comparable standards would not apply to U.S. BHCs with less than \$50 billion in consolidated assets.
- In its details, the Proposal contains several layers of requirements that create an unlevel playing field for FBOs and, by definition, are inconsistent with national treatment. These include the bifurcated single counterparty credit limit (“SCCL”) with cross-default features that are inapplicable to U.S. BHCs and separate U.S. liquidity requirements that do not permit reliance on credit risk mitigation from non-U.S. affiliates.
- The Proposal takes only minimal steps to exercise the Board’s authority to tailor the Section 165 Standards to FBOs. It would impose costly and burdensome requirements on a significant number of FBOs that present no meaningful risk to U.S. financial stability, and FBOs with more substantial U.S. operations would be subject to categorical, one-size-fits-all requirements that fail to take into account relevant distinctions between FBOs.
 - Due to the Board’s interpretation of the scope of Section 165 as applied to FBOs, the Proposal would apply to over one hundred FBOs, the significant majority of which conduct limited U.S. banking operations and have no meaningful systemic footprint. In contrast, the Board has proposed to apply Section 165 Standards to only 24 U.S. BHCs.
 - For example, an FBO with \$50 billion of global consolidated assets, but only a \$100 million branch in the United States, would be required to develop systems to conduct the daily credit exposure calculations based on complex methodologies required to comply with the Board’s proposed SCCL, even though the likelihood of the SCCL applying a binding constraint in these circumstances, and the relevance of the FBO to U.S. financial stability, would be negligible.
 - Congress cannot possibly have intended the Board to implement Section 165 in a manner such that nearly 80% of the banking organizations subject to enhanced prudential requirements would be institutions headquartered outside the United States.



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- The Board's attempts to tailor several of the Proposal's requirements for FBOs, which we support, do not go far enough to avoid unnecessary burdens on FBOs. Overbroad application of the Proposal's requirements will inevitably discourage affected FBOs from preserving and expanding the financial services they currently provide to U.S. customers, and would divert the Board's scarce supervisory resources away from more important areas for financial stability focus. Appropriate exemptions for smaller, non-systemically important FBOs would significantly lessen the overall burden and unintended effects of the Proposal.
 - By applying the Section 165 Standards to all IHCs, the Proposal also fails to consider the enumerated factors in Dodd-Frank that Congress indicated should inform the Board's consideration of how to tailor enhanced prudential standards to SIFIs, including whether affected FBOs control an insured depository institution.
 - Finally, for the small handful of FBOs whose U.S. operations could actually present risks to U.S. financial stability ("SI-FBOs"), the Proposal fails to tailor its requirements to the actual risks to financial stability these SI-FBOs may represent, resulting in the application of overbroad and poorly targeted measures that do not address specific sources of risk.
- In many respects, the Proposal appears to be seizing an opportunity to remake FBO regulation more generally on the basis of a narrow grant of statutory authority in Section 165 to adopt heightened prudential standards for a class of FBOs to protect U.S. financial stability. The Proposal is noteworthy for its adoption of an IHC requirement in implementing Section 165 when Section 165 does not contemplate the use of an IHC (unlike other provisions of Dodd-Frank that expressly empower the Board to require certain companies to create an IHC).
 - By targeting the U.S. broker-dealer operations of FBOs, the Proposal also raises serious questions regarding the Board's legal authority to impose broadly applicable capital standards on functionally regulated broker-dealers operating in compliance with SEC capital requirements.



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- *The Proposal is inconsistent with international efforts to promote coordination and cooperation among home and host country supervisors, and incentivizes the adoption of uncoordinated, protectionist measures in other jurisdictions.*
 - The Proposal departs from the historical and recently confirmed consensus that cross-border coordination and cooperation is essential to effective supervision of internationally active banks.
 - In our view, the Board’s supervisory objectives can most effectively be met through the types of coordinated action among global supervisors that the Basel Committee and FSB have been promoting.
 - The approach mandated by Congress, which would look first to comparable home country standards, would create affirmative incentives for home country supervisors to coordinate and cooperate in the development of internationally harmonized standards for all internationally active banking organizations.
 - At its core, the Proposal’s “every country for itself” approach to cross-border banking regulation creates disincentives for such cooperation and coordination and, indeed, would incentivize other countries to adopt reciprocal measures potentially to the detriment of U.S. banking organizations and to financial stability more generally.
 - While the IIB strongly supports the objective of preserving and promoting U.S. financial stability, in our view that objective can best be met through approaches that target specific threats to U.S. financial stability and otherwise adhere to international agreements and principles regarding home-host coordination.
 - Of particular note, the Proposal is at odds with the development of new alternatives for global resolution planning, including the “single point of entry” model that for many FBOs presents the best hope of achieving an orderly resolution with minimal risk to taxpayers.
 - Indeed, the Proposal would create incentives for resolution authorities in the United States and elsewhere to act independently on a territorial basis to protect their national interests instead of taking a coordinated, global approach to resolution of SIFIs, creating a heightened risk of disorderly recovery and resolution scenarios.



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- Although recent statements by some have suggested that other countries such as the UK have already taken actions along the lines of the Proposal, the Board has not identified any other country that imposes a similar IHC requirement whereby all foreign bank-owned local, non-branch operations must be moved under a locally organized holding company subject to separate consolidated capital and liquidity standards.
 - Most countries, like the United States, apply local capital and liquidity requirements to the foreign-owned functionally regulated financial subsidiaries, such as banks and broker-dealers, located in their jurisdictions.
 - Enhanced liquidity standards adopted by the UK in 2009 establish local liquidity requirements for foreign-owned functionally regulated subsidiaries and branches, but importantly permit waivers of the liquidity requirements for foreign firms that satisfy certain conditions, including the broad equivalence of the firm's home country liquidity regime and arrangements providing for ongoing communication and cooperation between the UK and other relevant supervisors.
 - The Board's Proposal would represent a significant step beyond what other countries currently require, or have proposed to require, from foreign banks operating in their jurisdictions.
- Recent statements by some have also suggested that the steps some jurisdictions are considering to protect their local, retail deposit-taking institutions from other wholesale and investment banking operations call into question the likelihood of parental or home country support for those institutions' affiliated U.S. operations.
 - Our attached comments explain more fully why the actual proposals being considered in the EU, Switzerland and the UK, to name three examples, do not justify the imposition of a blanket IHC requirement in the United States.
 - In brief, the Board's Proposal would not take into account the preliminary nature of these reforms, would give no credit for other steps these jurisdictions are taking to improve the safety and soundness of the consolidated parent institutions (and not just their local, retail deposit-taking operations), and discounts the significant legal and



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reputational incentives for parent FBOs and their supervisors to ensure the continued survival of their U.S. operations.

- Indeed, proposals to require financial firms to place retail deposit-taking institutions behind a “ring-fence” subject to restrictions on certain nonbanking activities and on transactions with nonbanking affiliates closely resemble the restrictions on insured depository institutions currently in force in the United States.
- *The Proposal would expand the extraterritorial effects of U.S. regulations on FBOs without deference to home country regulatory standards.*
 - The Board’s explanation of the Proposal suggests that one motivating factor for some of its elements was a desire to reduce the extraterritorial reach of Section 165, a goal we wholeheartedly support. However, in certain respects the Proposal would create unwarranted extraterritorial effects.
 - For example, the early remediation triggers in the Proposal would effectively and unilaterally subject FBOs on a parent consolidated basis to a U.S.-prescribed minimum leverage ratio beyond what is required under home country implementation of Basel III.
- *By limiting the organizational flexibility of FBOs’ U.S. operations, the Proposal would create disincentives for growth and barriers to entry or expansion into the United States.*
 - The Proposal would curtail the choices available to FBOs with respect to their preferred organizational structure for their U.S. operations. This would interfere with legitimate settled business expectations for those FBOs currently operating in the United States, and would erect barriers to entry for foreign banks that might consider entering the U.S. market now or in the future.
 - In our view, the Board should consider in the course of analyzing any future iteration of the Proposal the extent to which the provisions in the Proposal would constitute a barrier to trade in financial services, including the extent to which it could affect future discussions and negotiations with other countries and regions regarding liberalizing restrictions on cross-border financial services.
 - The Board should also consider the potential effects in future systemic stress scenarios on FBOs’ willingness to expand in the United States through acquisitions of troubled U.S. institutions. As regulatory requirements imposed on



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the U.S. operations of an FBO become more stringent, they will discourage FBOs from providing a key stabilizing source of capital in the event of a future U.S. banking crisis.

A more tailored approach to implementing the Section 165 Standards would be a superior means to achieve the Board's objectives consistent with the statutory requirements of Dodd-Frank. In our view, tailoring could best be achieved through selective, risk-based application of heightened standards to systemically important FBOs. Alternatively, although inferior to the first approach, the Board could introduce greater tailoring into the Proposal by providing for a waiver process whereby affected institutions could obtain relief from "baseline" categorical requirements under Section 165, similar to the approach to local liquidity requirements adopted in the UK.

The attached comments set forth the legal and factual basis for the concerns we express in this letter and discuss each of the principal components of the Proposal in detail. They explain our alternative proposal for implementing the Section 165 Standards and explore how this alternative could be applied to address the Board's concerns in a tailored, proportionate manner. They also identify specific concerns with each aspect of the Proposal that we believe would need to be addressed if the Board were to implement the Section 165 Standards in a manner that resembles the current Proposal, and suggest solutions to our specific concerns. In particular, a number of our specific comments contain suggestions for how to tailor the Proposal to bring its scope of application more in line with the purpose of Section 165—addressing systemic risks to the United States.

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The Institute appreciates the opportunity to comment on the Proposal. Please contact the undersigned or our General Counsel, Richard Coffman (646-213-1149; rcoffman@iib.org) if we can provide any additional information or assistance.

Very truly yours,

A handwritten signature in black ink that reads "Sarah A. Miller". The signature is written in a cursive style and is positioned above a light gray rectangular box.

Sarah A. Miller
Chief Executive Officer



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INSTITUTE OF INTERNATIONAL BANKERS

COMMENTS OF THE INSTITUTE OF INTERNATIONAL BANKERS

ON THE

NOTICE OF PROPOSED RULEMAKING

ON ENHANCED PRUDENTIAL STANDARDS

AND EARLY REMEDIATION REQUIREMENTS

FOR

FOREIGN BANKING ORGANIZATIONS

AND

FOREIGN NONBANK FINANCIAL COMPANIES

(Regulation YY: Docket No. 1438 and RIN 7100-AD-86)

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Introduction

The IIB strongly supports enhancing U.S. and global financial stability through robust supervision and regulation—including the appropriate implementation of Section 165. We commend the continuing efforts of the international regulatory community to develop, harmonize and coordinate the many fundamental regulatory reforms currently underway, which are intended to reduce financial stability risks present in the international financial system. At the same time, the development of enhanced bank supervisory standards should be balanced against the priority of promoting U.S. and global economic recovery and minimizing the risk of unintended adverse consequences.

Given these competing priorities, we would urge the Board to approach implementation of Section 165 cautiously. We are concerned that, by basing a new framework for regulation of FBOs too heavily on the “lessons learned” in the last crisis, the Board is creating new, unintended and poorly understood vulnerabilities that could very well trigger or exacerbate a future crisis. And designing the framework based on overbroad assumptions to address generalized trends may impose unnecessary constraints on institutions and markets beyond the targeted concerns, with adverse effects for financial markets and economic growth. Taking into consideration the high stakes of reform and the continuing evolution of the international framework for systemic risk regulation, the Proposal’s dramatic departure from current practices merits much more careful and thorough study than the Proposal appears to have received based on the Proposal’s preamble and the public statements of the Board.

Congress appreciated that the implementation of Section 165 would require the Board to address difficult practical and legal issues with respect to harmonizing the U.S. framework with international agreements and home country standards. In Section 165, Congress gave explicit directions to the Board regarding how to confront these issues. The Board is required to give due regard to the principle of national treatment and equality of competitive opportunity, to take into account the extent to which the FBO is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States and to take into account differences among financial institutions based on their systemic footprints and risk profiles.¹ Dodd-Frank also affirmed Congress’ intention that the Board promote the international cooperation and coordination necessary for effective consolidated supervision of internationally active banks.²

As currently drafted, the Proposal fails to comply with the clear statutory directives of Section 165, and it presents several potential risks to U.S. financial markets and the global economic recovery. We urge the Board to revise its Proposal and issue a new proposed rule that appropriately tailors the application of the Section 165 Standards to FBOs in a manner that gives due consideration to consolidated home country regulation, national treatment and the

¹ See Dodd-Frank §§ 165(b)(2) – (3).

² See Dodd-Frank § 175(c) (“The Board . . . and the Secretary [of the Treasury] shall consult with their foreign counterparts and through appropriate multilateral organizations to encourage comprehensive and robust prudential supervision and regulation for all highly leveraged and interconnected financial companies.”).

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actual risks that certain SI-FBOs may present to U.S. financial stability, while minimizing unintended negative consequences for customers, FBOs, the U.S. economy and U.S. financial stability that would result from the overbroad approach of the current Proposal.

Organization of Our Comments

In the comments that follow, we discuss each of the principal components of the Proposal in detail.³ In Part I, we discuss the most radical element of the Proposal—the Board’s proposed IHC requirement. Our comments address the reasons why in our view an across-the-board IHC requirement should not be imposed on any category of FBO. We also discuss our suggestion, building on the approach developed in the white paper we published last August (the “IIB White Paper”),⁴ for an alternative means to accomplish the Board’s objectives—the SI-FBO Framework—that we believe would be more effective, more consistent with the letter and spirit of Section 165 and less likely to create unintended consequences for financial markets and the U.S. and global economic recovery. Finally, Part I addresses specific concerns about certain aspects of the IHC requirement as it has been proposed, in the event that the Board were to retain some form of IHC requirement in its final rules implementing Section 165.

Parts II through VII discuss the remaining components of the Proposal, including capital and liquidity standards, single counterparty credit limits, stress testing, early remediation and risk management standards. As in the case of the IHC requirements, we identify specific concerns with the standards as proposed and suggest revisions that could address our concerns. Part VIII addresses various timing issues regarding the Proposal, including its proposed effective dates and the need to take an iterative approach to certain elements of the Proposal.

The Appendix to our comments includes a catalogue of the questions that the Board posed for public comment in the Proposal, together with cross-references to where the answers to those questions are discussed in our comments or, in some cases, with answers following the relevant question in the Appendix.

Our comments focus primarily on the particular issues raised by the Board’s proposed method of applying Section 165 to FBOs and on certain other aspects of the Proposal of special interest to internationally headquartered banks and international markets. In addition, however, the IIB reiterates its support for the specific recommendations and suggestions in the joint comment letter dated April 27, 2012, submitted by The Clearing House Association L.L.C., the American Bankers Association, The Financial Services Roundtable and the Securities Industry and Financial Markets Association on the Domestic Proposal (the “Joint Trade Associations Letter”).⁵

³ Capitalized terms defined in the cover letter accompanying these comments have the same meaning when used herein.

⁴ See IIB, Application of Heightened Prudential Standards under Section 165 of the Dodd-Frank Act to Systemically Important Foreign Banking Organizations (Aug. 31, 2012).

⁵ Available at http://www.federalreserve.gov/SECRS/2012/May/20120501/R-1438/R-1438_042712_107270_542775340448_1.pdf.

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I. The Intermediate Holding Company Requirement

A. The IHC Requirement Is Fundamentally Flawed and Should Be Replaced with a More Tailored Approach to Supervision and Regulation of FBOs as Required by Congress

1. General

Section 165 directs the Board to establish heightened capital, liquidity and other prudential standards and establish an early remediation regime for certain large BHCs and FBOs.⁶ In doing so, the Board is required to take into account differences among financial institutions based on their systemic footprints and risk profiles. Section 165 imposes additional requirements on how the Board should approach establishing these standards for FBOs. Specifically, the Board is required to give due regard to the principle of national treatment and equality of competitive opportunity, and to take into account the extent to which an FBO is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States.

Recognizing that implementation of the Section 165 Standards for FBOs presents challenges distinct from, and more complex than, their implementation for U.S.-headquartered BHCs (“U.S. BHCs”), we published the IIB White Paper last August to propose the “SI-FBO Framework” for the application of the Section 165 Standards to FBOs. We designed the SI-FBO Framework to be consistent with the Board’s statutory mandates under Section 165, long-standing and current principles regarding the regulation of internationally active banks, and the current U.S. and international efforts to implement heightened prudential regulation of systemically important financial institutions (“SIFIs”) in a consistent and coordinated manner.

We continue to believe that implementation of the Section 165 Standards for FBOs (i) should be closely tailored to the actual risks to U.S. financial stability posed by each FBO and (ii) that only a very small subset of FBOs—a group of FBOs we refer to as “SI-FBOs”—have the potential to present risks to U.S. financial stability.⁷ In our view, the statutory mandate to tailor the Section 165 Standards to actual systemic risks is especially important in the context of the Board’s host country supervision of SI-FBOs, where SI-FBOs are already subject to heightened prudential standards in their home countries implemented in accordance with internationally agreed standards for SIFIs, and where coordination and cooperation between home and host country regulators is key to effective supervision. In our view, the Board’s objectives can be more effectively and efficiently met through coordinated action among global supervisors, rather than unilateral attempts to address the local aspects of cross-border concerns.

⁶ Section 165 also directs the Board to establish heightened capital, liquidity and other requirements for nonbank financial companies designated by the Financial Stability Oversight Board (the “FSOC”) for supervision by the Board. We would respectfully submit that fundamental fairness would suggest that once a nonbank financial company, foreign or domestic, is so designated it should have sufficient opportunity to consider and provide comment on the impact and application of the Section 165 Standards to the company.

⁷ In general, we would expect that only a subset of the FBOs identified by the Financial Stability Board (“FSB”) as global systemically important banks (“G-SIBs”) would be SI-FBOs in the United States. See, e.g., FSB, Update of Group of Global Systemically Important Banks (Nov. 1, 2012).

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The Proposal, however, takes an unnecessarily categorical approach to the Section 165 Standards, including the IHC requirement. Even for SI-FBOs, the Proposal would apply the IHC requirement across the board, without consideration for the meaningful differences among those FBOs in their systemic risk characteristics or consideration of whether actual threats to U.S. financial stability would justify the requirement for individual FBOs.⁸ In addition, the Proposal would mandate an IHC for a much broader set of FBOs than just SI-FBOs, including many FBOs that do not present any significant risks to U.S. financial stability. The Proposal would require any FBO with \$50 billion or more in global consolidated assets and \$10 billion or more in U.S. non-branch assets to organize an IHC and hold its U.S. subsidiaries (other than U.S. subsidiaries held under Section 2(h)(2) of the Bank Holding Company Act of 1956, as amended (the “BHC Act”)) through that IHC. Regardless of whether the IHC controls a U.S. bank, the IHC would be subject to U.S. capital and liquidity requirements and other prudential standards as if it were a U.S. BHC. The Board has estimated that approximately 26 FBOs would be required to form an IHC, 8 of which would have less than \$50 billion in their IHC.⁹

Especially at this threshold, the IHC requirement would impose costly regulatory requirements on many FBOs whose U.S. operations are not relevant to U.S. financial stability, with potentially significant collateral consequences for FBO participation in U.S. financial markets. These requirements would include corporate restructuring, duplicative local capital and liquidity standards and credit exposure limits, and inappropriate one-size-fits-all risk management requirements. If initially imposed on a broad basis, many of these requirements would be difficult to unwind if they later turned out to be unnecessary or counterproductive.

Section 165 has a clear and singular purpose—enhancing prudential standards specifically to protect U.S. financial stability. Unlike other provisions of Dodd-Frank, such as some of the more generally applicable provisions of Title VI, Section 165 is explicitly tied to its legislative purpose. It is not a general grant of authority to the Board to re-make FBO supervision and regulation.¹⁰ In addition, unlike other provisions of Dodd-Frank, Section 165

⁸ See Oliver Wyman Study at 5 – 9 (studying the impact of the Proposal requires analysis of the various business models of FBOs’ U.S. operations).

⁹ See 77 Fed. Reg. at 76,676. As we have observed before in comments on the Board’s proposed rules to implement the resolution planning requirements of Section 165(d) of the Dodd-Frank Act, we believe that the Board should interpret the \$50 billion asset threshold in Section 165 to apply to FBOs on the basis of only their U.S. assets, and that the Board has ample authority to do so. See IIB, Comment Letter on Federal Reserve Board and FDIC Joint Notice of Proposed Rulemaking Regarding Resolution Plans and Credit Exposure Reports (June 10, 2011), available at http://www.iib.org/associations/6316/files/20110610ResPlanNPR_IIB_final.pdf.

¹⁰ The weight of the references in the preamble to the Proposal appear to confirm that the Board views the Proposal as specifically implementing Section 165 and not resting on its authority under the BHC Act (by extension through the IBA) to supervise and regulate FBOs in the United States. See, e.g., 77 Fed. Reg. at 76,635 (“The proposal would implement [Section 165] through requirements that enhance the Board’s current regulatory framework for [FBOs] in order to better mitigate the risks posed to U.S. financial stability by the U.S. activities of [FBOs].”). Other references are more ambiguous, suggesting that the Proposal may have been designed to serve more than one purpose. See, e.g., 77 Fed. Reg. at 76,628 (“The financial crisis also demonstrated that large [FBOs] operating in the United States could pose similar financial stability risks. Further, the crisis revealed weaknesses in the existing framework for supervising, regulating, and resolving significant U.S. financial companies, including the U.S. operations of large

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does not contemplate the use of an IHC as a tool to implement the Board’s statutory authority.¹¹ In this sense, the novelty of the IHC requirement and its legislative character—without solid grounding in the text of Section 165—underscores that it is a policy measure that should more appropriately be considered in the legislative process rather than imposed by regulatory fiat.¹²

[FBOs].”) and 76,629 (“The following sections provide a description of changes in the U.S. activities of large [FBOs] during the period that preceded the financial crisis and the financial stability risks posed by the U.S. operations of these companies that motivate certain elements of this proposal.”) (emphasis added).

¹¹ Compare Dodd-Frank § 165 (lacking any reference to IHCs) with Dodd-Frank §§ 167(b) (authorizing IHCs in the context of nonbank financial companies designated by the FSOC) and 626 (authorizing IHCs in the context of grandfathered unitary savings and loan holding companies). The purpose of the optional IHC requirement in Sections 167(b) and 626 is to permit the Board to require a separation of financial and nonfinancial activities in companies that, unlike BHCs, are permitted to conduct both commercial and financial activities. Nowhere in Dodd-Frank did Congress endorse the idea of using an IHC to enforce a geographic separation of capital and liquidity in the regulation of U.S. financial activities.

The authority in Section 165 the Board cites for the IHC requirement is its authority to prescribe additional prudential standards, including “contingent capital, public disclosures, short-term debt limits, and such other prudential standards as the Board determines appropriate.” 77 Fed. Reg. at 76,631 (citing Dodd-Frank § 165(b)(1)(B)). However, it would be difficult to suggest that Congress envisioned the Board would use its supplementary authority under Section 165, which was intended to give the Board flexibility to create targeted prudential requirements such as contingent capital and short-term debt limits, to impose an across-the-board IHC requirement on all large FBOs—particularly when Congress specifically granted the Board authority under Dodd-Frank to require the creation of IHCs in other contexts where Congress perceived there to be a potential need for the IHC construct, but did not do so here. Reading Section 165(b)(1)(B)(iv) as authority to prescribe a new requirement that so fundamentally varies from longstanding and codified U.S. policy is contrary to principles of statutory construction. See, e.g., *Central Bank of Denver v. First Interstate Bank*, 511 U.S. 164, 176-77 (1994) (“Congress knew how to impose aiding and abetting liability when it chose to do so.”). See also *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-15 (2001) (“[W]here general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.”); *Jarecki v. G. D. Searle & Co.*, 367 U.S. 303, 307 (1961) (“The maxim noscitur a sociis, that a word is known by the company it keeps, while not an inescapable rule, is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress”).

¹² Indeed, in suggesting that the IHC requirement’s departure from existing approaches was not unprecedented, Governor Tarullo cited the International Banking Act of 1978 and the Foreign Bank Supervision and Enforcement Act of 1991 (“FBSEA”), two major legislative enactments directly targeted at FBO regulation, in which Congress adopted statutory reforms (including based on input from the Board). See Regulation of Foreign Banking Organizations, Speech by Governor Daniel K. Tarullo at the Yale School of Management Leaders Forum (Nov. 28, 2012) (the “Tarullo Speech”), available at <http://www.federalreserve.gov/newsevents/speech/tarullo20121128a.htm>. In our view, that comparison only highlights the legislative character of the IHC requirement. Indeed, every other significant structural limitation on FBOs operating in the United States has resulted from an act of Congress. See, e.g., FBSEA § 214(a), codified as 12 U.S.C. § 3104(d)(1) (requiring FBOs that accept retail deposits in the United States do so through an IDI subsidiary, and not a branch).

To the extent that the Proposal were instead grounded in the BHC Act, by extension through the IBA, all of the same policy concerns and concerns about lack of specific authority for such a radical structural requirement would apply, but the legal authority questions discussed below in Part I.A.9 would become even more serious, in light of the specific restrictions on the Board’s ability to impose capital standards on the functionally regulated subsidiaries of BHCs and FBOs in Section 5(c)(3) of the BHC Act. See 12 U.S.C. § 1844(c)(3).

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Moreover, if adopted as proposed, the IHC requirement would create significant risks of harm to the U.S. economy and U.S. financial stability by driving many FBOs to reduce their U.S. presence, concentrating U.S. financial markets and encouraging reciprocal actions by other host countries, including with respect to the non-U.S. operations of U.S. BHCs. Its repercussions would also be felt globally, as FBOs would be forced to tie up additional capital and liquidity in the United States, reducing lending worldwide at a time when the global economy remains fragile. In our view, the Board's proposal does not reflect adequate consideration and study of these potentially serious implications. If quantitative studies have been conducted by the Board, the data and results of those studies should be included in the administrative record for the Proposal, and subject to further public comment.

We strongly urge the Board to adopt an approach more consistent with the SI-FBO Framework introduced in the IIB White Paper in lieu of a categorical IHC requirement. At any threshold, the IHC requirement is fundamentally inconsistent with the letter and intent of Section 165, and in particular with the Board's mandates to take into account comparable home country standards and to give due regard to the principle of national treatment and competitive equality. The IHC requirement is also incompatible with the requirement to provide for meaningful tailoring of the Section 165 Standards to reflect the actual risks to financial stability posed by FBOs with different characteristics and U.S. footprints. Even in the case of SI-FBOs, the IHC requirement is too blunt an instrument to address residual systemic risk after taking into account comparable home country standards.¹³

2. *The IHC Requirement Fails to Consider Comparable Home Country Standards Applied on a Consolidated Basis, as Required by Dodd-Frank*

Section 165 specifically directs the Board to take into consideration home country standards that apply to an FBO on a consolidated basis and are comparable to those applied to financial companies in the United States.¹⁴ Compliance with this directive requires consideration of both the home country regime applicable to an FBO and the effect of that regime on the U.S. operations of the specific FBO. This directive also makes plain that the starting point for analysis of comparable standards is the consolidated organization, not individual U.S. subsidiaries or banking offices. Moreover, this provision makes clear that comparable home country regulation is presumed to be the default applicable regulatory standard, absent some material inconsistency that could be addressed through targeted U.S. regulation.

Despite this statutory directive, the Proposal's IHC requirement ignores the existence and quality of home country supervision and its implications for the U.S. operations of FBOs. Nothing in the preamble to the Proposal suggests that the Board took into account when designing the IHC requirement whether FBOs—either individually or by category—are subject to comparable home country heightened prudential standards. Instead, the IHC requirement appears to be premised on the judgment that no level of home country regulation can be sufficient to

¹³ As discussed in greater detail below, if the IHC requirement were to be retained, the Board should at a minimum revise the threshold for the requirement to include only SI-FBOs and make other adjustments to avoid unnecessarily burdening those FBOs with more modest U.S. operations.

¹⁴ See Dodd-Frank § 165(b)(2)(B).

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protect the United States from the U.S. activities of an FBO without the imposition of local structural and regulatory requirements, including the ring-fencing of capital and liquidity in the United States. In our view, this characteristic alone is enough to make the IHC requirement fundamentally inconsistent with Congress' directive in Section 165. It is also inconsistent with the Board's responsibility to work towards stronger, more consistent and effective global regulation of SIFIs.¹⁵

Instead of prescribing geographical ring-fencing and localized requirements, Section 165 focuses on the regulation of banking organizations at the consolidated level, taking into account the activities of the entire group. This focus is natural and obvious for U.S. BHCs, where the Domestic Proposal would correctly apply the Section 165 Standards to top-tier U.S. BHCs on a consolidated basis. However, the language, structure and historical context of Section 165 likewise contemplate a focus on FBOs as consolidated organizations as a starting point. For example, Section 165 specifically directs the Board to take into consideration comparable home country requirements that apply to FBOs, which by definition would apply to FBOs on a consolidated basis. In the same section, it specifically refers to application of the Section 165 Standards to a "foreign-based bank holding company", and not, for example, to foreign bank-controlled BHCs.¹⁶ These and the other statutory cues discussed above, combined with the recognition that top-tier consolidated regulation is a long-standing principle of the international framework for cross-border regulation of banking organizations¹⁷, allow only one reasonable conclusion regarding the intent of Section 165. The Board should focus on the global consolidated operations of an FBO when deciding how to apply the Section 165 Standards to an FBO, and its evaluation of an FBO's operations should be consistent with long-standing principles of deference to home country supervision and prudential regulation.

A focus on consolidated supervision and regulation is logical in the context of U.S. systemic risk regulation. For many institutions, the perceived and actual strength of an operating financial or banking subsidiary is closely tied to the strength of its top-tier parent. In addition, effective liquidity, capital and risk management require consideration of all the obligations and resources of the entities involved, which cannot be appreciated in full without taking into account the entire consolidated group. Attempts to apprehend liquidity, capital, risks and exposures at a local, legal entity level will understandably distort the actual position of the organization. Indeed, risks to U.S. financial stability may originate from activities located both

¹⁵ See Dodd-Frank § 175(c).

¹⁶ See Dodd-Frank § 165(b)(2)(B).

¹⁷ See, e.g., Basel Committee, Consolidated Supervision of Banks' International Activities (Mar. 1979) ("it should be a basic principle of banking supervision that the authorities responsible for carrying it out cannot be fully satisfied about the soundness of individual banks unless they are in a position to examine the totality of each bank's business worldwide."). The Basel Committee capital accords clearly reflect this focus on consolidated regulation and supervision of banking organizations. See Basel Committee, International Convergence of Capital Measurement and Capital Standards: A Revised Framework, paras. 20 – 23 (June 2006) ("Basel II") (clarifying that minimum capital requirements under the Basel II Accords apply at the top-tier parent holding company of each banking group and at each bank on a consolidated basis); Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, para. 47 (Dec. 2010; revised June 2011) ("Basel III") (adopting the same scope of application as Basel II). For ease of reference, we refer to the regulatory capital framework published by the Basel Committee, as amended from time to time, as the "Basel Capital Framework".

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inside and outside of the United States. It is precisely because of the need to consider the entire corporate group that the IIB commented on the Domestic Proposal to urge the Board to appropriately tailor the Domestic Proposal's application to U.S.-domiciled bank holding companies controlled by FBOs.¹⁸

The Board has indicated that one potential benefit of an IHC requirement is an effective limitation on the extraterritorial reach of Section 165. That is, by creating an IHC requirement and attaching heightened prudential standards to the IHC, the Board avoids applying those standards to the FBO at the parent level. However, in our view this perception misses the original concept behind Section 165 and Congress's direction to the Board to take into account comparable home country standards. Applying Section 165 to an FBO on a consolidated basis in accordance with that mandate does not necessarily require imposing U.S. requirements on the FBO at the parent level. What it does require is an analysis of the FBO's home country standards and whether they are comparable. If they are comparable, then Section 165 authorizes the Board to defer to those home country standards and avoid imposing an additional layer of U.S. requirements on any part of the FBO group. Consequently, looking to the FBO on a consolidated basis as a starting point and evaluating the FBO's home country standards is perfectly consistent with an objective of limiting the extraterritorial impact of Section 165—an objective that IIB supports.¹⁹

The Board also suggests that relying solely on home country implementation of the enhanced prudential standards would present challenges because “[s]everal of the [Dodd-Frank] Act’s required enhanced prudential standards are not subject to international agreement.”²⁰ We respectfully submit that this consideration also misses the point of the Section 165 mandate to consider comparable home country standards in several respects. First, Section 165 does not require there to be an international agreement in force before the Board must consider whether an FBO is subject to comparable home country standards, and the absence of an international agreement does not prevent the Board from considering the existence and effectiveness of comparable home country standards for individual FBOs.²¹ If the Board’s statement is a prediction that home country standards are unlikely to be comparable in the absence of an international agreement, we believe that such an assertion at a minimum should be tested on its merits. For example, there is no international agreement (yet) on credit exposure limits. However, all or virtually all SI-FBOs are subject to a home country large exposures

¹⁸ In our comment letter of April 30, 2012, we urged the Board to consider the broader context of benefits from and obligations to parent FBOs in which these U.S. BHC subsidiaries operate. See IIB, Comment Letter on the Domestic Proposal (Apr. 30, 2012), available at http://www.federalreserve.gov/SECRS/2012/May/20120511/R-1438/R-1438_043012_107220_582244408948_1.pdf.

¹⁹ In addition, as noted in the sections that follow, there are several places in the Proposal where the Board in fact extends the extraterritorial effects of Section 165 in ways not contemplated by Congress, suggesting that limitation of Section 165’s extraterritorial reach is not an overarching principle behind the Proposal as a whole.

²⁰ 77 Fed. Reg. at 76,637.

²¹ As noted below, Section 165 directs the Board to consider the extent to which “the” FBO is subject to comparable home country standards, not whether all FBOs are subject to internationally agreed standards. See Dodd-Frank § 165(b)(2)(B).

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regime that applies on a consolidated basis (consistent with early Basel Committee guidance on the role of such standards in effective bank supervision). Second, the absence of international agreements (whatever the relevance of that consideration) does not apply to all of the enhanced standards, and the Board is required under Section 165 to take into account comparable home country standards in each of the relevant categories. Indeed, most of the major components of the enhanced prudential standards called for by Section 165 are in fact subject to existing or developing international agreements (capital, liquidity, etc.). The most effective way for the Board to address concerns over the quality or stringency of international standards is to work in the international arena to strengthen them.

(a) Statutory Mandate and Historical Context for Evaluation of Comparable Consolidated Home Country Supervision

The Board's existing framework for evaluating home country capital regulations is the appropriate model for Section 165's mandate to consider comparable consolidated home country supervision. Because of their parallel statutory language and closely related substantive issues, the Board's implementation of Section 165 should parallel that of the Gramm-Leach-Bliley Act ("GLBA") provision regarding an FBO's ability to qualify as a financial holding company ("FHC").²² Section 165 directs the Board to "give due regard to the principle of national treatment and equality of competitive opportunity" and "take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States" in applying the Section 165 Standards.²³ This language parallels the statutory criteria for extending to an FBO the powers available to an FHC under the GLBA, which directs the Board to "apply comparable capital and management standards to a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, giving due regard to the principle of national treatment and equality of competitive opportunity."²⁴

Congress clearly intended the Board to draw on the well-developed framework for evaluating whether the consolidated home country regulation of an FBO is comparable to U.S. regulation of BHCs. Indeed, the directive to look to comparable home country supervision is even clearer in Section 165 than it is in the GLBA. Whereas the GLBA requirement to "apply comparable standards" makes no direct reference to home country standards and could have been read as a directive to create and impose comparable standards, Section 165's directive to "take into account . . . home country standards that are comparable" is an even clearer mandate to evaluate home country standards and to credit them where comparable to U.S. requirements. The closely related subject matter of the two provisions—home country regulation of capital levels and other core prudential matters—underscores the intent behind the use of parallel language. Just as the Board looks to home country implementation of the Basel Capital Framework for the GLBA's "well capitalized" requirement,²⁵ so too should it look to home country regulation, including

²² See GLBA, Pub. L. No. 106-102, § 103(a), 113 Stat. 1338, 1347 (1999), codified at 12 U.S.C. § 1843(l)(3).

²³ Dodd-Frank § 165(b)(2).

²⁴ 12 U.S.C. § 1843(l)(3).

²⁵ See 12 C.F.R. § 225.90 – .92.

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implementation of the Basel Committee’s and FSB’s SIFI-related recommendations, as the presumptively applicable prudential standard under Section 165.

(b) Application of the Section 165 Standards to FBOs

To give effect to Section 165’s focus on the consolidated operations of banking organizations and to comply with its directive to consider comparable home country supervision, the Board must consider both the overall characteristics of the home country regime applicable to an FBO as a consolidated entity, including home country implementation of globally agreed enhanced standards for SIFIs, and the implications of that regime for the U.S. operations of the FBO. FBOs have a variety of business objectives and legal and operational formats for their U.S. operations, and the interaction between these structures and each FBO’s home country regime should be considered. Given the diversity of structures and business models, and the variations among home country regulatory regimes, an individualized assessment of each FBO’s home country regulation in light of its unique structure will be required.

Current supervisory practices, such as the Board’s strength-of-support assessment (“SOSA”), should provide a framework for building a systemic risk assessment of home country regimes on these principles, and can be supplemented with additional scrutiny as required.²⁶ We expect these analyses will confirm that few FBOs present systemic risks to the United States, and that home country implementation of heightened standards for SIFIs, and broader reforms of financial institution regulations generally, have reduced the systemic risk profile of the U.S. operations of those FBOs that truly are SI-FBOs.²⁷ Of course, individual analysis of each SI-FBO’s U.S. operations and global risk profile would be appropriate and expected, but if a SI-FBO’s home country regulation is broadly comparable to U.S. and international standards, and the SI-FBO is in compliance with those requirements, the Board should impose additional heightened requirements only where pockets of unaddressed risk in the institution’s U.S. operations threaten U.S. financial stability in a way that is not addressed by home country standards.

In light of the continuing development of national and international reform efforts, the Board will need to monitor SI-FBO home country developments on an ongoing basis. The SI-FBO Framework we outline below would allow for tailoring of the Section 165 Standards to the unique circumstances created by the interaction of evolving home country regimes, the developing U.S. regulatory landscape, and the scope and legal structure of each SI-FBO’s U.S. operations. As a result, the Board would be able to continue to evaluate—and adjust, where

²⁶ See Board Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations § 2001.1.

²⁷ In the case of FBOs that are not “SI-FBOs”, categorical determinations of comparability on a jurisdiction-by-jurisdiction basis, at least as an initial presumption for FBOs headquartered in the jurisdiction, would be an appropriate way to conduct the analysis, facilitating the effective exemption of such entities as we suggest below. Again, the Board has an existing model for making these determinations in the International Banking Act and Regulation K requirements for the Board to consider whether an international bank seeking entry into the U.S. banking markets is subject to “comprehensive supervision or regulation on a consolidated basis by its home country supervisor.” 12 C.F.R. § 211.24(c)(1)(i)(A); 12 U.S.C. §§ 3105(d)(2) and 3107(a)(2);.

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prudent to protect U.S. financial stability—the Section 165 Standards applicable to each SI-FBO in response to these changes.

3. *The Proposal Would Not Sufficiently Tailor the Implementation of Section 165*

In addition to the mandate to consider home country standards, Section 165 grants the Board authority to tailor the application of the Section 165 Standards by differentiating not only among categories of firms but also among individual firms on the basis of risk-related factors, and requires the Board to apply the most stringent Section 165 Standards only to those institutions that present the greatest risks to U.S. financial stability.²⁸ Congress required the Board to take into account differences among financial institutions based on their systemic footprints and risk profiles, with reference to the various factors enumerated in Dodd-Frank Section 113(a) and (b) as well as, among other things, whether the company owns an insured depository institution.²⁹ Not only is the Board’s general authority to tailor the Section 165 standards to individual firms clear in the text of Section 165, but Section 165 also directs the Board to exercise this authority with respect to FBOs on an institution-specific basis. Section 165 requires the Board, when applying the Section 165 Standards to “any” FBO, to consider the extent to which “the foreign financial company” is subject to comparable home country standards.³⁰ The use of the singular in this context demonstrates that Congress expected the Board to engage in an institution-specific analysis of comparable consolidated home country standards.

In most, if not all, cases, the IHC requirement is unwarranted by the actual risks to U.S. financial stability posed by the U.S. operations of FBOs. The Board should exercise its authority under Section 165 to effectively exempt those FBOs that do not present any systemic risks to the United States, and to tailor the application of the Section 165 Standards to the diverse risk profiles presented by SI-FBOs. The Board’s existing oversight of these institutions, including its strengthened on-site examinations,³¹ currently provides the Board with significant information on each SI-FBO as well as a framework for obtaining any additional information necessary to individually analyze and address the systemic risk profile of each SI-FBO. In addition, most of the material U.S. operating subsidiaries of FBOs are already subject to U.S. prudential regulation by their primary federal and/or state supervisors. These regulators can serve as additional sources for information regarding the SI-FBO’s U.S. operations, and can take steps to address risks identified by the Board pursuant to their traditional supervisory powers,

²⁸ See Dodd-Frank § 165(a)(2)(A) (capital structure, riskiness, complexity, financial activities and size are specifically enumerated factors to consider when tailoring the Section 165 Standards, but the Board may consider any other risk-related factor it deems appropriate).

²⁹ See *id.* §§ 165 (a)(2)(A) and (b)(3).

³⁰ *Id.* § 165(b)(2)(B) (emphasis added).

³¹ See Sarah J. Dahlgren, Executive Vice President, Federal Reserve Bank of New York, A New Era of Bank Supervision, Remarks at the New York Bankers Association Financial Services Forum (Nov. 11, 2011) (discussing recent restructuring of on-site supervision); Sarah J. Dahlgren, Supervisory Reform for Global Banks, Remarks at the Center for Transnational Legal Studies Seminar on the Impact of U.S. Regulatory Reform on Global Banks, New York City (Feb. 12, 2013) (discussing continued enhancements to the supervision of FBOs) (together, the “Dahlgren Remarks”).

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without the need for another layer of regulation. Careful tailoring will avoid mismatches between the risks presented by a particular institution and the impact of the Section 165 Standards on that institution. It will also avoid imposing requirements on a broad selection of firms that would prove difficult and costly to unwind if they later turned out to be unnecessary or counterproductive, given the large sunk costs to both firms and regulators alike of systems development and structural changes.

There are only a small number of FBOs that reasonably could be considered SI-FBOs. In those few cases, the operations of SI-FBOs that could create systemic risks are typically limited to specific areas of the U.S. financial markets (e.g., wholesale lending, short-term borrowing or capital markets activities). The limited scope of SI-FBO's systemically important activities weighs heavily in favor of solutions targeted to the specific risks raised by these activities. The Proposal's broad, one-size-fits-all approach is unnecessary for the other, non-systemically important U.S. operations of SI-FBOs, and potentially inadequate to address concentrated risks from specific activities.

Consideration of the risks presented by categories of FBOs and individual FBOs will give the Board the flexibility to be forward-looking and act decisively to address real risks to financial stability. The Board's limited resources should be focused on the particular structures and activities that could present real risks to U.S. financial stability, rather than the enforcement of categorical approaches applicable to all FBOs or SI-FBOs.

In this regard, we do not propose that the Board should wait until threats to U.S. financial stability materialize before imposing heightened standards. We recognize the potential limitations of such an approach, including dependence on a rapid supervisory action and the possibility of procyclical effects. Rather, the tailoring we suggest would allow the Board to address—proactively—specific systemic risks through targeted measures instead of addressing theoretical systemic risks through generic measures.³²

4. *The IHC Requirement is Inconsistent with International Regulatory Coordination and Cooperation, which Are Essential to the Effective Supervision of SIFIs*

The Board, like many national governments and other supervisors, is understandably concerned about potential threats to host country financial stability and host country creditors from the activities of global SIFIs headquartered in other jurisdictions. The Basel Committee, FSB and other international bodies have recognized host country concerns with cross-border banking operations, and are working to address them. In the Dodd-Frank Act, Congress recognized the importance of coordination and consultation with home country regulators. Dodd-Frank directs the Board to consider home country supervision of FBOs in connection with the Section 165 Standards³³ and requires consultation with home country regulators or consideration of home country regulation in connection with many other actions

³² See Oliver Wyman Study at 5 – 9 (analysis of impact of Proposal must start with analysis of varied FBO structures).

³³ See Dodd-Frank § 165(b)(2)(B).

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required or permitted by Dodd-Frank.³⁴ In addition, Dodd-Frank directs the Board and the Secretary of the Treasury to “consult with their foreign counterparts and through appropriate multilateral organizations to encourage comprehensive and robust prudential supervision and regulation for all highly leveraged and interconnected financial companies.”³⁵

For nearly forty years, the Basel Committee has led international efforts to coordinate the regulation of internationally active banks and developed principles for the allocation of supervisory responsibility between home and host jurisdictions. From the beginning, the allocation of responsibility for capital and liquidity regulation was a central issue for Basel Committee deliberation, as were the development of effective mechanisms for facilitating international coordination and cooperation. In the words of the Basel Committee’s first report on the subject, “adequate supervision of foreign banking establishments, without unnecessary overlapping, calls for contact and cooperation between host and parent supervisory authorities.”³⁶ As the Basel Committee and its recommendations have evolved through the years, international coordination has remained a core principle.³⁷ Regulatory authorities from the world’s major economies and financial centers, including the Board itself, have remained committed to the Basel Committee’s work throughout this time.

The fundamental allocation of home and host country responsibility developed by the Basel Committee’s members remains unchanged following the recent financial crisis. Core principles of the international framework include host country recognition of home country consolidated regulation and a strong emphasis on cooperation, appropriate sharing of information and coordination in the supervision of internationally active banks.³⁸ Indeed, international

³⁴ See, e.g., Dodd-Frank § 113(b)(2)(H) (requiring FSOC consideration of home country regulation when determining whether a foreign nonbank financial company should be subject to heightened prudential standards); Dodd-Frank § 113(f)(3) (requiring FSOC to consult with home country supervisors when making an emergency determination that a foreign nonbank financial company is subject to heightened prudential standards); Dodd-Frank § 121(d) (directing the Board to consider home country regulation if it promulgates regulations regarding application to foreign financial companies of its authority to mitigate a “grave threat to the financial stability of the United States” posed by a SIFI).

³⁵ Dodd-Frank § 175(c).

³⁶ Basel Committee, Report to the Governors on the Supervision of Banks’ Foreign Establishments, p. 2 (Sept. 1975). See also *id.* at pp. 3 – 4 (discussing the appropriate roles of host and parent supervisors in the regulation of liquidity and solvency).

³⁷ See, e.g., Basel Committee, Principles for the Supervision of Banks’ Foreign Establishments, p. 1 (May 1983) (“Adequate supervision of banks’ foreign establishments calls not only for an appropriate allocation of responsibilities between parent and host supervisory authorities but also for contact and cooperation between them. It has been, and remains, one of the Committee’s principal purposes to foster such cooperation both among its member countries and more widely.”).

³⁸ Compare Basel Committee, High-level Principles for the Cross-border Implementation of the New Accord (Aug. 2003), with Basel Committee, Consultative Document: Core Principles for Effective Banking Supervision (Dec. 2011) (Principle 3: Cooperation and Collaboration and Principle 13: Home-host relationships). See generally Basel Committee, Good Practice Principles on Supervisory Colleges (Oct. 2010).

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consensus regarding the value of cross-border coordination appears to be stronger, as recently affirmed by the Finance Ministers and Central Bank Governors of the G20.³⁹

The Basel Committee has played an active role in the international community's response to the financial crisis and the recognition that the preexisting international regulatory framework was insufficient to address issues of systemic risk. To address the problems posed by SIFIs to both home and host countries, the Basel Committee, as part of the Basel III capital accords, has proposed to apply additional capital buffers to G-SIBs and domestic systemically important banks ("D-SIBs").⁴⁰ These proposals would increase capital at the consolidated and sub-consolidated levels for internationally active banks identified as G-SIBs and D-SIBs, respectively, and should address many of the Board's concerns about the activities of SIFIs. We would suggest that the Board work within this internationally agreed upon framework to the maximum extent possible, understanding that U.S. statutory requirements may require certain modifications and divergences.⁴¹

The FSB has also demonstrated leadership in addressing financial stability in an internationally coordinated manner, and is implementing programs to establish itself as a more permanent and financially autonomous body, with a more vigorous role in monitoring member implementation of agreed standards.⁴² It is also engaged in comprehensive "peer reviews".⁴³ These include both jurisdiction-specific reviews, which involve a comprehensive review of the financial supervisory and resolution regimes of a specific country, as well as thematic reviews, which provide a cross-country comparison of a specific aspect of financial regulation (e.g.,

³⁹ See Communiqué of Finance Ministers and Central Bank Governors of the G-20, paragraph 4 (Oct. 14-15, 2011). See also Michel Barnier, European Commissioner for Internal Market and Services, Why Global Markets Require Global Rules—and US-EU Cooperation, Remarks at the Transatlantic Finance Initiative, New York, New York (Feb. 15, 2013) ("Barnier Speech") (discussing need for cooperation between the United States and the EU), available at http://europa.eu/rapid/press-release_SPEECH-13-125_en.htm?locale=en; Timothy Lane, Deputy Governor of the Bank of Canada, Financial Stability in One Country?, Remarks to the Weatherhead Center for International Affairs, Harvard University, Cambridge, Massachusetts (Feb. 11, 2013) ("Lane Speech") (warning about the dangers of financial protectionism), available at <http://www.bankofcanada.ca/2013/02/speeches/financial-stability-in-one-country/>.

⁴⁰ See Basel Committee, A Framework for Dealing with Domestic Systemically Important Banks (Oct. 2012) (the "D-SIB Framework"); Basel Committee, Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement (Nov. 2011).

⁴¹ Indeed, it is noteworthy that the D-SIB Framework agreed upon by international regulators makes no mention of forcing subsidiarization or creation of IHC-like structures.

⁴² See FSB, Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability ("FSB Progress Report"), Section 3 (June 19, 2012) (discussing member progress on improving capacity to resolve SIFIs and on improving the intensity and effectiveness of SIFI supervision); id. at Section 11 (discussing reforms for strengthening the independence and financial autonomy of the FSB). The Leaders and Finance Ministers of the G20 endorsed these efforts. See G20 Leaders Declaration, para. 38 (June 19, 2012); Communiqué of Finance Ministers and Central Bank Governors of the G20, para. 7 (June 19-20, 2012).

⁴³ See FSB Progress Report, Section 10 (discussing completed and planned peer reviews). The Basel Committee is also engaged in a series of peer reviews regarding implementation of the Basel Capital Framework and other Basel Committee initiatives. See, e.g., Basel Committee, Basel III Regulatory Consistency Assessment Programme (Apr. 2012); Basel Committee, Peer Review of Supervisory Authorities' Implementation of Stress Testing Principles (Apr. 2012).

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deposit insurance regimes).⁴⁴ In addition, the FSB framework for resolution authorities and resolution planning provides for host country recognition of the home country resolution of cross-border institutions, but acknowledges that unilateral host country action might be appropriate “in the absence of effective international cooperation and information sharing.”⁴⁵ The FSB and Basel Committee peer reviews of home country regulation, increased monitoring of member implementation of agreed standards and consideration of host country concerns in its substantive recommendations can be expected to strengthen the basis for appropriate host country recognition of the consolidated capital, liquidity and leverage oversight of home country regulators. Governor Tarullo’s recent appointment as chairman of the FSB’s standing committee on supervisory and regulatory cooperation provides an ideal opportunity for the Board to continue to push for consistent, heightened prudential standards across jurisdictions.

National actions taken in isolation, whether by host or home country supervisors, will necessarily be insufficient to address significant risks to financial stability, and are likely to be counterproductive. As expressed by the President of the Federal Reserve Bank of New York last year, “[a]t times, policies are designed with the goal of being ‘best’ at the national level. Yet the resulting mix of national policies is distinctly inferior to what a well-coordinated global regime could have produced.”⁴⁶ In addition, “regulatory harmonization and cooperation, by necessity requires trust and a willingness to share relevant information across jurisdictions. A corollary to this is that national regulators need to be willing to constrain their unilateral actions somewhat in order to facilitate engagement and cooperative solutions on a global basis.”⁴⁷ If major jurisdictions follow the Board’s proposed route and adopt inward-looking territorial approaches to the regulation of SI-FBOs, they will have abandoned the commitment to coordination and cooperation necessary to detect, mitigate and resolve systemic risks.

Pending development and implementation of robust and internationally coordinated minimum standards, approaches to systemic risk supervision that are unduly focused on domestic resources present acute risks for all global banking organizations, including those headquartered in the United States. They also indirectly threaten the global economic recovery in the short term and global financial stability in the long term. The fragmentation of capital and liquidity that would result from unilateral host country approaches is well recognized, and the ensuing effects on the availability of credit and other financial services are clear.⁴⁸ Less well recognized, but of

⁴⁴ See, e.g., FSB, Thematic Review on Resolution Regimes (Apr. 11, 2013); FSB, Thematic Review on Deposit Insurance Systems (Feb. 8, 2012).

⁴⁵ See FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, p. 13 (Oct. 2011) (“FSB Resolution Framework”) (“Legislation and regulations in jurisdictions should not contain provisions that trigger automatic action in that jurisdiction as a result of official intervention or the initiation of resolution or insolvency proceedings in another jurisdiction, while reserving the right of discretionary national action if necessary to achieve domestic stability in the absence of effective international cooperation and information sharing.”); see also FSB, Thematic Review on Resolution Regimes (Apr. 11, 2013).

⁴⁶ William C. Dudley, Remarks at the Swiss National Bank-International Monetary Fund Conference, Zurich (May 8, 2012), available at <http://www.newyorkfed.org/newsevents/speeches/2012/dud120508.html>.

⁴⁷ Id.

⁴⁸ See, e.g., Parts I.A.6 and I.A.8 below. See also Oliver Wyman Study at 23 – 26 (concluding that the Proposal would have a negative effect on availability of credit).

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considerable importance, is the potential for fragmentation to increase concentration within national markets and thereby increase the systemic risk vulnerabilities of those markets.⁴⁹ Systemic risk supervisors in all jurisdictions, especially the financial centers of the global economy, must be mindful of the need to balance their own host country interests against broader international considerations.⁵⁰

Instead of seeking national solutions to international concerns, the Board should focus on continuing to strengthen the international consensus and framework for systemic risk regulation. In addition to exercising its persuasive powers at the FSB, Basel Committee and other international bodies, it can also seek to develop national regulations that create positive incentives for cooperation and information sharing from FBOs and their home country supervisors. As just one example of this approach, the UK Prudential Regulatory Authority's ("PRA", formerly the Financial Services Authority, or "FSA") liquidity regulations permit waivers of local liquidity requirements provided the UK branch or subsidiary, its parent and its home country supervisor satisfy certain ongoing conditions, including home country supervisory equivalence and cooperation and adequate access to information.⁵¹ These approaches encourage firms and their supervisors to work together. In contrast, the Board's chosen approach is likely to encourage more fragmentation and divergence as each country looks to protect its parochial interests.

5. *The IHC Requirement Is Inconsistent with the Principle of National Treatment and Equality of Competitive Opportunity*

The Board's Proposal to require FBOs to restructure their U.S. operations by moving their U.S. subsidiaries into an IHC is fundamentally inconsistent with the core U.S. policy of national treatment and competitive equality as expressed in Section 165 of the Dodd-Frank Act.⁵² Simply expressed, U.S. BHCs, although subject to similar regulatory requirements as IHCs, would be regulated on the basis of their global operations, while an IHC would be regulated on the basis of only the U.S. operations of the FBO. This fundamental divergence

⁴⁹ See Oliver Wyman Study at 25 – 27 (concluding that the Proposal could result in higher concentration of credit markets as FBOs withdraw capacity and resources).

⁵⁰ See, e.g., International Monetary Fund ("IMF") Press Release: IMF Holds High-Level Roundtable on Structural Banking Reform (Apr 23, 2013) (describing a "High-Level Roundtable on Structural Banking Reform" at which "[a] number of participants felt that ensuring the mutual consistency of national policies is vitally important to attenuate complexity of implementation and avoiding unintended cumulative costs on the global financial system."), available at <http://www.imf.org/external/np/sec/pr/2013/pr13139.htm>.

⁵¹ See Strengthening Liquidity Standards, FSA Policy Statement 09/16 (Oct. 2009). We understand that, consistent with FSA/PRA expectations, many firms operating in the UK have applied for and received modifications. See *id.* at 21 – 22 ("In practice, we expect that many of the affected firms will apply for, and receive, modifications of the self-sufficiency requirement.").

⁵² Section 165(b)(2)(A) of the Dodd-Frank Act requires the Federal Reserve to "give due regard to the principle of national treatment and equality of competitive opportunity" when applying Section 165's enhanced prudential standards to FBOs. See also, e.g., U.S. Department of the Treasury and Board, Subsidiary Requirement Study, Dec. 18, 1992, Appendix D; S. Rep. No. 1073, 95th Cong. 2d Sess. 2 (1978), reprinted in 1978 U.S.C.A.N. 1421 (explaining that the guiding principle of the International Banking Act is "the principle of parity of treatment between foreign and domestic banks in like circumstances"—i.e., "national treatment").

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from the principle of national treatment presents itself in every facet of the Proposal, as elaborated in the discussion that follows.

(a) The General Discriminatory Effect of the IHC Requirement

Pursuant to the IHC requirement, FBOs would be required to organize essentially all of their U.S. subsidiaries under a single IHC subject to capital, liquidity, governance, risk management, stress testing and other requirements imposed under the Section 165 Standards. Whereas an IHC would be regulated on the basis of only the U.S. subsidiaries of the FBO, U.S. BHCs would be regulated on the basis of their global operations (although subject to similar regulatory requirements). Permitting a U.S. BHC to take into account its global consolidated operations when complying with the Section 165 Standards while depriving an IHC, as part of an FBO, of that same opportunity would violate the core U.S. policy of national treatment and competitive equality.

We recognize, of course, that the determination of national treatment and an assessment of discriminatory effects depends in the first instance on how a comparison is defined. It appears from the preamble to the Proposal that the Board views the IHC requirement as consistent with competitive equality because an IHC would be subject to comparable regulatory requirements and heightened prudential standards as a U.S. BHC. In our view, this analysis misses the true question of national treatment and competitive equality by ignoring certain key facts relevant to the question. If an IHC were a top-tier parent (*i.e.*, if the FBO parent and its non-U.S. affiliates were removed from the structure), then an IHC and a U.S. BHC might be a relevant comparison. However, an IHC is only part of a consolidated FBO. Ignoring the existence of the FBO parent in making the relevant national treatment comparison generates a fundamentally incomplete analysis of the overall regulatory framework, and is especially inappropriate given the clear statutory direction in Section 165 to look to comparable consolidated home country standards.

Furthermore, even if the comparison were made as between an FBO's IHC standing alone (*i.e.*, disregarding the FBO parent) and a U.S. BHC, the Proposal would still not be consistent with national treatment and competitive equality for several reasons. First, IHCs would be subject to certain heightened prudential standards under the Proposal (*e.g.*, single counterparty credit limits) at a \$10 billion consolidated assets level, whereas U.S. BHCs would not be subject to comparable heightened prudential standards until they reached a \$50 billion consolidated assets level.⁵³ Second, IHCs would be subject to heightened prudential standards regardless of whether they controlled a bank—or any other type of insured depository institution (“IDI”). In contrast, a U.S.-headquartered holding company that is not a BHC or designated by FSOC as a nonbank SIFI (for example, a U.S.-headquartered investment banking group with one or more broker-dealer subsidiaries) would not be subject to heightened prudential standards.⁵⁴

⁵³ This national treatment violation is even more acute outside the IHC component of the Proposal. Certain requirements of the Proposal would apply to the U.S. operations of dozens of FBOs whose U.S. assets are much smaller than even \$10 billion. The disparity in scope of application is thus even more severe in such situations when the comparison is posed based solely on the size of U.S. operations.

⁵⁴ See Part I.A.9 below for a discussion of how the indirect application of bank regulatory standards to FBO-affiliated broker-dealers through an IHC is inappropriate as a matter of policy and legal authority.

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The fact that an IHC would be affiliated with an FBO that operates a branch in the United States does not change this disparity since (a) the comparison being posed for this purpose is the Board's stated comparison, *i.e.*, IHC (disregarding the parent FBO) vs. U.S. BHC, and (b) with the exception of a very limited number of "grandfathered" branches, the FBO's branches would not be IDIs.

In other words, whether the IHC is viewed in the context of being part of an FBO group or viewed in isolation disregarding its FBO parent, the IHC requirement in the Proposal is inconsistent with national treatment and competitive equality as a general matter.

(b) IHC Capital Requirements

The Proposal's regulatory capital requirements for IHCs would also be inconsistent with national treatment and competitive equality because U.S. BHCs would be evaluated based on their global consolidated capital and assets, while IHCs would be evaluated based solely on their U.S. capital and assets. (Further, unlike IHCs, intermediate BHCs controlled by U.S. BHCs would not be subject to consolidated minimum capital standards.) Importantly, IHCs would constitute only a subset of the overall assets of the FBO and, therefore, would not be able to take into account their parents' holdings of low-risk assets outside of the United States when calculating their capital ratios, potentially distorting the overall asset mix upon which capital requirements are imposed. And IHCs without IDI subsidiaries would be subject to capital requirements that would not apply at all to equivalent U.S.-headquartered holding companies without IDI subsidiaries (unless such companies were affirmatively designated by the FSOC as nonbank SIFIs under Section 113 of Dodd-Frank).

FBOs would also face more complex and burdensome capital calculations than similarly situated U.S. BHCs. Requiring IHCs to calculate their risk-based capital requirements under U.S. capital standards in addition to their home country standards, which may have different definitions and methodologies, could result in IHCs being directly or indirectly subject to up to four overlapping and at least partially redundant sets of capital calculations: (i) home country advanced approaches; (ii) home country Basel I floor (extended indefinitely in 2009); (iii) U.S. advanced approaches; and (iv) the U.S. Collins amendment floor calculation (which significantly limits the benefits of the risk-sensitive advanced approaches by imposing risk-insensitive capital minimums). In addition, the FBO's functionally regulated subsidiaries would, like the functionally regulated subsidiaries of U.S. BHCs, also be subject to standalone capital requirements, such as IDI risk-based capital and leverage requirements, the U.S. Securities and Exchange Commission's ("SEC") net capital rule for broker-dealers and the capital regimes for swap dealers and security-based swap dealers proposed by the U.S. Commodity Futures Trading Commission ("CFTC") and SEC. IHCs would also be required to comply with both U.S. leverage requirements and their home country leverage requirements (either as currently existing and/or as implemented under Basel III), and inconsistencies between the two would force IHCs (but not U.S. BHCs) to manage to the stricter requirement in every case. Managing and maintaining capital buffers above multiple minimum sub-consolidated capital requirements would invariably require an FBO to maintain more capital (to avoid falling under any one buffer)

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that it would have to maintain if holding a single capital buffer against a single set of equivalent standards applied at the consolidated level.⁵⁵

(c) Liquidity Requirements

The proposed liquidity buffer requirements similarly represent a denial of national treatment. The Proposal would require an FBO to maintain separate liquidity buffers for each of its U.S. branch network and its IHC, while under the Domestic Proposal U.S. BHCs would be subject to only one liquidity requirement for their global combined operations. FBOs would therefore be forced to fragment their liquidity among multiple geographic locations and legal entities (e.g., global/home country buffer, U.S. branch network buffer and IHC buffer), and would even have to develop and maintain separate liquidity buffers within the United States. In stark contrast, U.S. BHCs would be permitted to maintain a single liquidity buffer. Although the Board asserts that the liquidity buffer requirement is not intended to increase FBOs' overall consolidated liquidity requirements, in practice the loss of netting and diversification and lack of harmonization between jurisdictions is likely to lead to higher liquidity requirements both locally and for an FBO's consolidated operations.⁵⁶

In addition, the Proposal would place significant limits on the ability of an FBO—but not a U.S. BHC—to take account of intragroup funding flows. It would require an FBO's IHC to hold a liquidity buffer against the IHC's short-term (30-day) internal obligations to its U.S. branch network, its parent bank and its other U.S. and non-U.S. affiliates, calculated under stressed conditions. Similarly, it would require an FBO's U.S. branch network to hold a liquidity buffer against the branch network's short-term internal obligations to its affiliated IHC, its other U.S. and non-U.S. affiliates and to the non-U.S. operations of its parent bank. It would also prevent an FBO's U.S. branches or IHC from using funding flows between each other and from other parts of the corporate group to offset short-term obligations to unaffiliated parties when calculating their liquidity buffers against short-term external, third party obligations. By contrast, a U.S. BHC would be required to calculate only one liquidity buffer, against its short-term external obligations, and could rely on all U.S. and global sources of liquidity to meet those obligations.

Finally, the Proposal does not automatically permit FBOs to count home country sovereign debt as highly liquid assets for purposes of the liquidity buffer, even though U.S.

⁵⁵ This issue would be further exacerbated if other countries decide to follow a similar path as the Board and impose their own territorial capital requirements. The overall effect of each successive country to adopt a protectionist, territorial approach to capital regulation is to increase overall trapped capital by more than the respective minimums required, as institutions must maintain healthy buffers in each jurisdiction to avoid falling below the relevant minima. See, e.g., Parts I.A.8 and II.B.9.

⁵⁶ See Proposal at 76,642; Committee on the Global Financial System (“CGFS”), Funding Patterns and Liquidity Management of Internationally Active Banks, CGFS Papers No. 39 at 24 (May 2010) (“Local liquidity buffers would, in principle, not have to be held twice, as the holdings of a foreign subsidiary could also count towards the fulfillment of the liquidity requirement of the consolidated entity in the home country. Yet this may be difficult to achieve in practice. In addition, local liquid asset requirements are likely to be higher than those at the consolidated level because of the loss of diversification. Fragmentation will thus probably imply an increase in group-wide required liquidity holdings, and/or could lead banking groups to shift liquidity risks to the balance sheets of entities that are not subject to regulation.”).

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sovereign debt automatically qualifies. Automatically qualifying only U.S. government securities is inconsistent with national treatment, because a U.S. BHC would be permitted to invest freely in the obligations of its home government to satisfy its liquidity obligations, while an FBO's ability to invest in the obligations of its home government to satisfy its liquidity obligations would be restricted.

(d) Single Counterparty Credit Limits

The Proposal's SCCLs, when combined with home country and other preexisting U.S. regulation of credit exposure to a single counterparty, would subject FBOs to multiple, overlapping and redundant credit exposure limits: (i) IHC-specific SCCLs based on IHC capital; (ii) SCCLs applied to the FBO's combined U.S. operations (including both its U.S. branches and its IHC) based on global consolidated capital; (iii) federal and/or state lending limits applicable to U.S. bank subsidiaries and branches; and (iv) home country credit exposure limits.⁵⁷ U.S. BHCs would only be subject to global SCCLs based on their global consolidated capital and federal and/or state lending limits applicable to their bank subsidiaries.

Compounding the added burden of complying with multiple credit exposure limits that would not apply to U.S. BHCs, IHCs subject to SCCLs would be treated less favorably than U.S. BHCs subject to the same limits, because SCCLs for an IHC would be set as a percentage of the IHC's capital (e.g., reflecting only the U.S. subsidiaries of the FBO), while SCCLs for U.S. BHCs would be set as a percentage of the BHC's global consolidated capital, resulting in much lower exposure limits for the IHC of an FBO than the U.S. operations of a U.S. BHC of equivalent size. In addition, FBOs would be subject to a cross-trigger provision that would prevent lending by any part of an FBO's combined U.S. operations, including its U.S. branches, if the IHC's (smaller) SCCL to a particular counterparty was breached. U.S. BHCs would not be subject to limits on lending based on the credit exposure of only a subpart of the BHC's collective operations.

Finally, the Proposal's SCCL provisions discriminate against FBOs in their ability to use collateral, hedges, netting agreements and other offsets to reduce their overall net exposure to a counterparty. Neither the IHC nor the combined U.S. operations of an FBO would be permitted to count as collateral (i) cash on deposit in an account of the IHC's non-U.S. affiliates or branches or (ii) debt or equity securities in which their non-U.S. affiliates or branches (rather than the IHC or any part of the FBO's combined U.S. operations) hold the relevant security interest. It also appears that an FBO may not be permitted to take advantage of hedges, netting agreements and other offsets involving the FBO's non-U.S. affiliates or branches. In contrast, U.S. BHCs would be able to count collateral, hedges, netting agreements and other offsets from any part of their global operations.

⁵⁷ See, e.g., 12 C.F.R. Part 32 (Office of the Comptroller of the Currency ("OCC") lending limits rule); New York Banking Law § 202-f (New York State lending limits applicable to state-licensed branches of FBOs); Basel Committee, Consultative Document: Supervisory Framework for Measuring and Controlling Large Exposures (Mar. 2013) (the "Basel Large Exposure Consultation"); Basel Committee: Core Principles for Effective Banking Supervision (Sept. 1997) ("supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers"); UK Prudential Regulatory Authority, Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU"), ch. 10 (UK large exposures requirements).

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(e) Stress Testing and Risk Management

Under the Proposal, FBOs would be required to run both (i) home country capital and liquidity stress tests at the global consolidated level and (ii) separate capital and liquidity stress tests for their IHCs pursuant to U.S. requirements. FBOs would also have a separate liquidity stress test for their U.S. branch network. U.S. BHCs would not be subject to similar redundant requirements, as the Domestic Proposal requires only one set of capital and liquidity stress tests for a U.S. BHC's global operations.⁵⁸

FBOs would also be subject to other redundant risk management requirements on top of their home country supervisor's requirements, including U.S.-specific liquidity planning and requirements to establish separate governance structures focused on U.S. risk management, including a specifically designated U.S. risk committee and a U.S. chief risk officer ("CRO"). U.S. BHCs are only required have one risk committee and one CRO for the BHC's global consolidated operations.

(f) Early Remediation

FBOs would be subject to a cross-trigger provision whereby, if either an FBO's IHC or its combined U.S. (or global) operations trips an early remediation trigger, both the IHC and the FBO's combined U.S. operations would be subject to automatic early remediation measures—even if the triggering event is wholly attributable to the IHC or to the FBO's branches and non-U.S. operations. (In particular, if either the FBO's global operations or its IHC crosses a capital trigger, both would be subject to early remediation measures.) U.S. BHCs would be subject to automatic early remediation triggers based solely on their global consolidated operations, and not based on the performance of any one part of the BHC's operations.

(g) Up-Front and Future Tax and Other Restructuring Costs

The IHC requirement would require any FBO with \$50 billion or more in global assets and \$10 billion or more in U.S. non-branch assets to move its U.S. subsidiaries underneath an IHC. U.S. BHCs are under no similar obligation to restructure. Although the costs of this restructuring would vary from entity to entity depending on the current structure of their operations, most FBOs would be forced to incur costs that would not apply to U.S. BHCs. Internal corporate reorganizations typically require a significant amount of expense and time, as unexpected issues invariably emerge. As discussed below, in many cases this restructuring will also give rise to significant up-front tax costs to the FBOs, as well as future additional tax costs arising from the IHC requirement. For example, several of our members with substantial U.S. operations have estimated that the up-front tax costs of restructurings that would be required to implement the IHC requirement could be hundreds of millions of dollars each. In addition to the costs incurred by an FBO (in terms of money, management and other personnel hours, and legal resources) in order to move subsidiaries, establish new governance structures and funding mechanisms, reallocate assets (IP), revise employment contracts, and other activities necessary in

⁵⁸ Under U.S. law, both FBOs and U.S. BHCs would also be required to conduct capital stress tests for their U.S. IDI subsidiaries.

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any corporate reorganization, costs would also be incurred by the FBO's counterparties in order to, for example, assign or novate contracts and guarantees.⁵⁹

This extraordinary, costly and unexpected requirement would also disrupt FBOs' previously formed long-term expectations about their U.S. operations and change the calculus involved in their previous acquisition and investment decisions in ways that would not apply to U.S. BHCs. Forcing a corporate restructuring on a banking organization solely because of its foreign ownership is another example of how the IHC requirement would violate national treatment.

FBOs typically hold their U.S. subsidiaries through a variety of structures resulting from business, regulatory, historical, tax or other considerations. For example, some FBOs may hold their U.S. securities dealing subsidiary under a foreign securities dealer, and their U.S. insurance company under a foreign insurance holding company, etc., each essentially operating as a "division" of the foreign parent. Alternatively, U.S. subsidiaries that became part of an FBO group as a result of a foreign business acquisition may continue to be owned under their historical parent because of the synergies of maintaining that structure and/or the tax costs of modifying the ownership structure. FBOs may also hold certain U.S. subsidiaries through their U.S. branches, including special purpose vehicles ("SPVs") and limited liability companies ("LLCs") that are disregarded entities for U.S. tax purposes and that are set up to hold certain real estate or other assets or to engage in financing or hedging activities, typically directly for the branches. Thus, the IHC requirement is not merely "slotting" an IHC into the U.S. structure, but will seriously disrupt the governance efficiencies and business line cohesion that has been crafted by FBOs to effectively manage their businesses

The IHC requirement would require FBOs to transfer most of their U.S. subsidiaries under a single U.S. IHC. For many FBOs, these transfers would give rise to significant up-front U.S. and non-U.S. tax costs because the intragroup transfers would be taxable dispositions of the subsidiaries. Thus, the FBOs would be subject to tax on the amount, if any, by which the fair market value of the stock (or assets) of the transferred U.S. subsidiary exceeds the tax basis (carrying cost) of such stock (or assets). Moreover, many foreign countries impose transfer taxes (such as stamp duties) on the gross value of the shares of stock being transferred.

To illustrate, assume an FBO in a European country with a 30% corporate tax rate and a 1% stamp tax has a U.S. insurance subsidiary with a tax basis of \$100 million and a fair market value of \$1 billion. If it is required to transfer that subsidiary to an IHC, it could be subject to a \$270 million corporate income tax (\$900 million gain x 30%) plus a \$10 million stamp tax on the transfer.

The IHC requirement would also give rise to additional future taxes for many FBOs. For example, an FBO may hold certain U.S. subsidiaries directly through foreign holding companies rather than under a single U.S. holding company in order to enable it to sell those U.S. subsidiaries without being subject to U.S. taxation. Once those U.S. subsidiaries are held

⁵⁹ See Oliver Wyman Study at 16 – 19 (estimating both one-time up-front restructuring costs and ongoing compliance and monitoring costs of the Proposal).

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under an IHC, a future sale of those subsidiaries would be subject to U.S. taxation. While such taxation can be avoided by utilizing an LLC (which is treated as a pass-through entity for U.S. tax purposes) to satisfy the IHC requirement, in general, any dividends paid by the U.S. subsidiaries to their non-US parent in that case would be subject to a 30 percent withholding tax instead of the 5 percent rate or complete exemption from withholding tax that applies under applicable U.S. income tax treaties.

Additionally, U.S. branches of FBOs hold assets through LLCs for a variety of non-tax purposes (for instance protecting the FBO from legal liability) while still being able to offset future income and losses in respect of the subsidiary-held assets against losses and income of the FBO. These tax efficiencies would be lost if the U.S. subsidiary were moved under an IHC. The inability to achieve these tax efficiencies may also have important non-tax consequences, such as the impairment of deferred tax assets in the U.S. branch, which may require the FBO to increase its regulatory capital unnecessarily.⁶⁰

Moreover, if the IHC requirement necessitates the transfer of LLCs that are owned by the FBO's U.S. branch and that engage in financing or hedging activities relating to the branch's operations, the tax, regulatory, financial reporting and/or business objectives of the LLC's organization and operation could be undermined, thereby resulting in unanticipated ancillary costs.

Apart from up-front U.S. and non-U.S. tax costs from transferring subsidiaries to an IHC and future U.S. tax inefficiencies from holding those subsidiaries under an IHC, the IHC requirement may also result in future non-U.S. tax costs. FBOs may hold various subsidiaries in separate corporate chains to mitigate adverse tax consequences that may arise under the controlled foreign corporation rules of the FBO's home country if these subsidiaries were to be held under a single U.S. holding company. For example, under the Canadian foreign accrual property income ("FAPI") rules, tax credits in respect of FAPI may be deferred or disallowed if the FAPI subsidiary is part of the same U.S. consolidated group as other subsidiaries. To avoid these results, Canadian companies often hold their U.S. FAPI subsidiaries separately from other U.S. operating businesses.

The IHC requirement may also result in increased state tax burdens in some cases, due to changes in the applicable allocation formulas or in the eligibility for different tax regimes that apply to different types of businesses.

Finally, we note that the increased requirements for equity financing of an FBO's U.S. subsidiaries once they are moved under an IHC would eliminate some of the tax benefits of using debt to finance subsidiary operations. The loss of interest tax deductions once these subsidiaries are moved under an IHC will be a substantial annual tax cost to the FBO (in addition to the higher financial cost of equity funding).

⁶⁰ See Part I.C.2.g below for a discussion of U.S. branch subsidiaries that should be excluded from an IHC.

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6. *The IHC Requirement May Harm U.S. Financial Stability and Economic Growth and Reduce Competition in U.S. Financial Markets, and the Proposal Does Not Reflect Adequate Study or Consideration of these Risks*

The IHC requirement would strongly incentivize FBOs to reassess their U.S. strategies and consider whether, and to what degree, to pull back from the provision of financial services in the United States.⁶¹ The resulting reduction in the U.S. activities of FBOs would reduce credit availability and make the U.S. financial system more concentrated and vulnerable to financial shocks. To the extent large domestic banking organizations move into the space abandoned by FBOs, these institutions would become larger and the markets for such services would become more concentrated. So-called “shadow banking” entities might also occupy some of the functions currently performed by FBOs, resulting in a less regulated and less transparent financial system. Oliver Wyman conducted an empirical analysis of the Proposal’s likely effects using proprietary information from a cross section of FBOs’ U.S. operations. Their study’s findings are alarming in that they predict that every one of these negative impacts is likely to occur from adoption of the Proposal.

Despite characterizations to the contrary, the Proposal’s local capital and liquidity requirements for IHCs and U.S. branches would restrict the cross-border flow of capital and liquidity between an FBO’s U.S. and non-U.S. operations.⁶² By restricting the flow of capital and liquid assets out of the United States, the Proposal would discourage FBOs from moving resources into the United States, out of concern that resources devoted to the FBO’s U.S. operations would not be available to the consolidated organization in the future.⁶³ To the extent FBOs retain their U.S. operations, the need to maintain additional capital and liquidity reserves at the local level would also increase the cost of credit provided by FBOs to their U.S. customers. A recent International Monetary Fund (“IMF”) working paper demonstrated that the local “ring-fencing” of capital leads directly to larger capital needs at the parent and/or subsidiary level.⁶⁴ FBOs’ costs of funding, and therefore the costs of credit they provide, could increase even further if credit ratings agencies determine that the Proposal’s obstacles to the free intragroup

⁶¹ As we have noted in other contexts, this effect would be particularly pronounced near the “cliff” that would be created by the \$50 billion global asset threshold and the \$10 billion U.S. non-branch asset threshold. FBOs slightly above this level (or slightly below and growing) may seek to reduce (or artificially slow the growth of) their U.S. non-branch assets to avoid the burdensome costs and competitive disadvantage that would accompany being subject to the IHC requirement.

⁶² See Parts II and III below. Indeed, the preamble to the Proposal tacitly acknowledges this implication by recognizing that the current FBO supervisory framework has “increased global flows of capital and liquidity.” 77 Fed. Reg. at 70,629. We also note that the Proposal would restrict the flow of capital and liquidity within the U.S. operations (e.g., between the IHC and the branch network), further adding to costs and inefficiencies of operating in the United States.

⁶³ See Oliver Wyman Study at 27 – 29 (concluding that FBO response will likely be to reduce resources devoted to the United States).

⁶⁴ See Eugenio Cerutti, Anna Ilyina, Yulia Makarova and Christian Schmieder, Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks, IMF Working Paper WP/10/247 (Nov. 2010).

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flow of capital and liquidity—factors explicitly considered in credit rating agency bank rating methodologies—are high enough to merit a downgrade.⁶⁵

As FBOs reduce their U.S. footprints in reaction to the IHC requirement, U.S. financial institutions could be expected to fill some of the gaps left behind, though it is not clear whether U.S. banking institutions have capacity to fully compensate for the contraction. To the extent they do, a movement of U.S. firms into the void left by FBOs would reduce diversity and competition in U.S. financial markets.⁶⁶ U.S. financial markets would become more concentrated, and FBOs would be less available as alternative sources of liquidity and credit during periods of market or economic stress. The already relatively concentrated U.S. OTC and exchange-traded derivatives markets would likely become more concentrated in a few large, highly interconnected U.S.-headquartered institutions.⁶⁷ In addition, less-regulated shadow banking entities may assume a portion of the credit provision and financial intermediation roles now played by FBOs, resulting in diminished transparency and decreased regulation of the U.S. financial and credit markets.⁶⁸ As the Board notes in its Proposal, the presence of FBOs in the United States “has brought competitive and countercyclical benefits to U.S. markets.”⁶⁹ If the Proposal encourages FBOs to withdraw from U.S. markets or reduce their presence or activities, those benefits will, at least partially, be lost. The increased concentration and reduced transparency of U.S. financial services markets could significantly undercut Section 165’s intended benefits to U.S. financial stability.

More generally, the Proposal’s move towards geographic compartmentalization of capital and liquidity could make U.S. financial markets more sensitive to shocks occurring inside and outside the United States. Local capital and liquidity requirements can impede the appropriate allocation of resources by an FBO and its home country regulators during periods of stress, limiting their ability to respond quickly and decisively to challenges to the strength of the FBO and therefore increasing the likelihood that—all else being equal—the institution could

⁶⁵ See, e.g., Fitch Ratings, Global Financial Institutions Rating Criteria at 11 (Aug. 2012) (“[R]egulatory issues play an important role in the analysis of a financial holding company and distinguish the analysis from that of unregulated corporate entities. Mutual support mechanisms, intercompany guarantees, and legal and/or regulatory restrictions surrounding flow of funds between subsidiaries and the parent company within a group that could ultimately impede or improve debt service capabilities in times of stress are factored into the analysis of an [financial institution].”) (emphasis added); Standard & Poor’s Ratings Services, Banks: Rating Methodology And Assumptions at para. 98 (Nov. 2011) (“Significant legal, tax, or regulatory constraints or characteristics of the group structure (for example, minority interests) [that] constrain the flow of capital among group members to absorb losses” are negative factors in assessing the quality of a bank’s capital).

⁶⁶ See Oliver Wyman Study at 26 – 28.

⁶⁷ As of April 1, 2013, approximately half of the firms that have registered with the CFTC as swap dealers were FBOs or firms controlled by FBOs. See CFTC, Provisionally Registered Swaps Dealers, <http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer> (last visited Apr. 25, 2015); National Futures Association, SD/MSP Registry, <http://www.nfa.futures.org/NFA-swaps-information/SD-MSP-registry.HTML> (last visited Apr. 25, 2013). See also Fitch Ratings, Derivatives and U.S. Corporations: Six Firms Continue to Dominate as Dodd-Frank Act Lurks (June 2012) (more than 75% of the derivatives assets and liabilities of the 100 U.S. firms surveyed are held by six large BHCs).

⁶⁸ See Oliver Wyman Study at 27.

⁶⁹ 77 Fed. Reg. at 76,629.

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fail.⁷⁰ And it would become more likely that an institution could be forced to turn to local governmental emergency liquidity facilities if liquidity cannot be easily reallocated across affiliates or jurisdictions, undercutting one of the stated goals of the Proposal. As the Board notes in the Proposal, some FBOs “were aided by their ability to move liquidity freely during the crisis.”⁷¹ The scale of this effect would of course vary depending upon the business model of the FBO in question—FBOs that follow a decentralized structure focused on retail banking and local deposits in host countries would be significantly less affected by limitations on the mobility of capital and liquidity than more centralized FBOs with significant investment and wholesale banking operations. Overall, however, although local capital and liquidity requirements might ensure there are local resources to meet local claims in the event of failure, they may also make draws on emergency lending facilities more common and the failure of parent FBOs more likely.

The resulting reduction in availability and increase in cost of FBO-provided credit could also have macroeconomic implications for the U.S. economy. FBOs were five of the top ten U.S. loan “bookrunners” in 2012, providing \$276 billion in credit.⁷² Twenty-five percent of the total commercial and industrial (“C&I”) lending in the United States is funded by the U.S. branches and IDI subsidiaries of FBOs,⁷³ and FBO-owned lenders were four of the top ten U.S. agricultural lenders in 2012.⁷⁴ FBOs also support the U.S. economy indirectly through their overseas activities, such as by financing international trade with the United States and facilitating foreign investment in the United States.⁷⁵ Accordingly, FBOs comprise an important source of

⁷⁰ See note 65 above. See also discussion in Part I.A.9 below.

⁷¹ 77 Fed Reg. at 76,630. The Board also observes, however, that “this model also created a degree of cross-currency funding risk and heavy reliance on swap markets that proved destabilizing”, and suggests that some FBOs were forced to deleverage when short-term U.S. dollar funding dried up and cross-currency swap prices rose. *Id.* The Board does not attempt to quantify the costs of this deleveraging, nor does it weigh the costs against the benefits of FBO participation in the United States. It also does not address the fact that, on the whole, FBOs have more recently shifted to a net due-to position with respect to their home offices. See, e.g., William A. Allen and Richhild Moessner, *The Liquidity Consequences of the Euro Area Sovereign Debt Crisis*, BIS Working Papers No. 390 at 20 (Nov. 2012) (describing a “large build-up of cash assets by [FBOs] in the United States in the first half of 2011, which was financed almost completely by borrowing (or loan repayments) from those institutions’ related foreign offices.”). The Allen and Moessner paper, which describes some of the stresses in foreign exchange swap markets cited as a concern by the Board, also demonstrates that European banks were able and willing to stand behind and fund their U.S. operations in the face of a withdrawal of wholesale funding by money market mutual funds. *Id.* at 20 – 21. Furthermore, there is evidence that, while U.S. lending activity contracted among Eurozone banks, overall syndicated lending did not change significantly, suggesting that other FBO branches picked up the slack. See Joseph Abate, *Downstreaming and Money Funds*, Barclays Research Report (2013).

⁷² See Thomson Reuters LPC League Tables, U.S. Bookrunner 2012, <http://www.loanpricing.com/analysis/leaguetables>.

⁷³ See Board Share Data for 2012, <http://www.federalreserve.gov/releases/iba/fboshr.htm>.

⁷⁴ See American Bankers Association, *Top 100 Farm Lenders Ranked by Dollar Volume*, <http://www.aba.com/Solutions/AgBanking/Documents/Top100AgBanksbyDollarVolume.pdf> (as of 1Q2012).

⁷⁵ The important role that FBOs’ U.S.-dollar activities play in supporting the U.S. economy was one reason the Board determined to support FBOs’ U.S. dollar liquidity through discount window access and, later, through FX swap lines established between the Board and other central banks. See, Linda Goldberg and David Skele, *Why Did U.S. Branches of Foreign Banks Borrow at the Discount Window during the Crisis?*, Liberty Street Economics, Apr. 13, 2011 (“In addition to containing further disruptions in the broad

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direct and indirect credit for the U.S. financial system. Curtailing their U.S. operations could have a real impact on U.S. economic growth.⁷⁶

In short, it appears that the Proposal's IHC requirement and associated regulatory requirements could create substantial direct and indirect costs that are relevant to an analysis of its merits. These include direct costs to affected FBOs in terms of increased capital and liquidity requirements, reduced lending capability and compliance costs and the corresponding drag on U.S. and global economic growth.⁷⁷ They also include indirect costs from the perspective of increased concentration in U.S. financial markets and potential adverse effects on financial stability. In our view, these costs have not been sufficiently addressed in the Proposal, and they certainly have not been weighed against the stated benefits of the Proposal (which are exclusively in the category of potential benefits to financial stability in certain scenarios).⁷⁸

The preamble to the Proposal devotes scant attention to the likely costs and repercussions of the IHC requirement, despite the distinct possibility that it could have significant negative effects on the U.S. economy and U.S. financial stability.⁷⁹ In other statements, Board Governors and staff have downplayed the likely downsides of the Proposal for economic and financial stability, international cooperation and reciprocal action.⁸⁰ The Proposal's failure to adhere to the statutory requirements that it take into account comparable home country standards, give due regard to the principle of national treatment and competitive equality and tailor the Section 165 Standards to reflect the actual risks to financial stability posed

financial system, the provision of liquidity to U.S. branches of foreign banks supported lending to U.S. firms. In markets that are increasingly integrated, U.S. branches are an important part of the U.S. financial system. They channel a sizable portion of the funds raised here and by their parent organizations back to the United States through their investments. In addition, foreign banks support the trade of other countries with the United States, facilitate international purchases of U.S. financial assets and foreign direct investment in the country, and deepen global financial markets for dollar assets.”), <http://libertystreeteconomics.newyorkfed.org/2011/04/why-did-us-branches-of-foreign-banks-borrow-at-the-discount-window-during-the-crisis.html>.

⁷⁶ See Oliver Wyman Study at 23-24 (capacity withdrawals likely to be across the spectrum of direct lending, capital formation, market-making and repo financing).

⁷⁷ See Oxford Economics, *Analyzing the Impact of Bank Capital and Liquidity Regulations on U.S. Economic Growth* (Apr. 2013) (estimating the potential range of outcomes for economic growth that may result from increased bank capital and liquidity requirements, based on recent literature studying the economic effects of such regulations). The study concluded that there was a high degree of uncertainty around the magnitude of adverse macroeconomic effects resulting from higher capital and liquidity requirements, and recommended that regulatory reform proposals should therefore be structured and implemented carefully to avoid unnecessary adverse effects. *Id.* at 3.

⁷⁸ See, e.g., IMF Press Release: IMF Holds High-Level Roundtable on Structural Banking Reform (“Managing Director Christine Lagarde . . . emphasized that since [structural reforms], applied to internationally active banks, are likely to have a far-reaching global impact, their design should reflect an equally extensive cost-benefit exercise.”) (emphasis added).

⁷⁹ See 77 Fed. Reg. at 76,636 (“Requiring capital and liquidity buffers in a specific jurisdiction of operation below the consolidated level may incrementally increase costs and reduce flexibility of internationally active banks that manage their capital and liquidity on a centralized basis.”)

⁸⁰ See, e.g., Tarullo Speech; Transcript of the Open Meeting of the Board Discussing the Proposal (Dec. 14, 2012) (the “[Meeting Transcript](#)”), available at <http://www.federalreserve.gov/mediacenter/files/open-board-meeting-transcript-20121214.pdf>.

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by FBOs with different characteristics and U.S. footprints, further draw into question the absence of an explicit, transparent and meaningful analysis of how the costs of the Proposal would be outweighed by its claimed benefits. The Board has not identified or released the quantitative assumptions, data or studies it has relied on to come to its conclusions, making it impossible for the public to comment meaningfully on the Board's underlying analysis.

Before proceeding with the Proposal, or in connection with issuing for public comment any revised proposal to implement Section 165, the Board should identify and publish these materials in order to give the public an opportunity to comment on the analytical basis for the Proposal and contribute to the Board's analysis. The published materials should include the results of its analysis of relevant costs and benefits and appropriate quantitative impact assessments that it has conducted or would conduct to justify the balance it has struck. While we recognize that the Dodd-Frank Act *per se* does not require the Board to conduct an explicit cost-benefit analysis in its implementing regulations, it remains a general U.S. policy that federal agencies, including independent agencies such as the Board, should analyze the costs and benefits of proposed regulations and consider less burdensome alternatives.⁸¹ And it is our understanding that the Board adheres to the general principles of cost-benefit analysis as a matter of policy, even if not required to do so by a specific statute.⁸²

In our view, a thorough analysis of the costs and benefits of the Proposal becomes especially important in light of the novelty of the IHC requirement, the danger of unintended costs and consequences and the fact that the FBO IHC requirement is a measure that Congress did not specifically authorize or direct the Board to implement in Dodd-Frank.⁸³

7. *The IHC Requirement Will Limit Access to U.S. Markets*

We are also concerned that the Proposal will restrict FBOs' access to U.S. markets by reducing the flexibility they currently have under existing law and regulation to organize their U.S. subsidiaries in a manner consistent with their global business models while complying with all relevant capital and liquidity regulations at the level of functionally regulated operational subsidiaries. Such a restriction is likely to constrain future U.S. investment by FBOs in their U.S. operations and could dissuade new entrants from establishing diversified financial services platforms in the United States.⁸⁴ For the reasons discussed above, we believe these consequences should be analyzed as indirect costs of the Proposal, including as it relates to the loss of the competitive and countercyclical benefits—recognized by the Board in the preamble to the Proposal—that FBOs provide to U.S. financial markets.⁸⁵

⁸¹ See Exec. Order No. 13,579, 3 C.F.R. 256 (2011).

⁸² See Letter from Chairman Bernanke to Cass Sunstein, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget, dated Nov. 8, 2011.

⁸³ See generally Oliver Wyman Study (empirical analysis of FBO data yields significant negative impacts of the Proposal that were not analyzed or addressed by the Board).

⁸⁴ See Oliver Wyman Study at 28 (Proposal could lead to structural homogeneity and diminished diversity of operations for existing and entering FBOs).

⁸⁵ See 77 Fed. Reg. at 76,630.

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In addition, in this respect the Proposal can fairly be characterized as erecting a barrier to trade in financial services.⁸⁶ Even if the U.S. government could successfully defend such a measure under relevant prudential carve-outs in a dispute under existing treaties (which we believe is by no means certain), it is bound to become a subject of discussion and, potentially, negotiation in connection with any future free trade agreement negotiations or negotiations over the liberalization of trade in financial services more generally. In our view, the Board should take into consideration and justify the Proposal from this perspective.

8. *The IHC Requirement Could Lead Other Countries to Take Reciprocal Measures, Exacerbating the Unintended Risks of the Proposal for U.S. and Global Financial Stability*

We are concerned that the IHC requirement could lead to reciprocal measures by other jurisdictions. Such measures may not necessarily be taken as overt retaliation against the United States (although such retaliation remains a distinct possibility), but could also result from other countries adopting the IHC model to protect their own interests in domestic financial stability, or as a counterweight to the U.S. approach. To the extent other countries do adopt reciprocal measures, and the Board's "every country for itself" approach becomes an international paradigm, the resulting "arms race" will profoundly affect the operations of both FBOs and U.S. banking organizations operating in those host countries. This trend could lead to a range of scenarios for global banks with broad implications for the global banking system, including, we submit, significant harm to financial stability and the U.S. and global economies.

Were each jurisdiction to adopt local capital and liquidity requirements, the result would further fragment and sideline global capital and liquidity, compounding the negative repercussions for economic growth and financial stability described above. The resulting collapse of international coordination and cross-border recognition of comparable supervisory standards for the regulation of capital and liquidity—core supervisory concerns—could also lead to the fragmentation of banking supervision more generally, threatening the basic tenets of cross-border supervision established through the Basel Committee. Such an outcome would have profoundly negative effects for local and international economic conditions and significantly impair the ability of regulators to monitor and address global risks to financial stability.

An approach that looks first to the comparability of home country standards applied to the consolidated FBO (as is required by Section 165) creates incentives for home country supervisors to continue to coordinate and collaborate in the development of heightened prudential standards for global banking organizations that protect their mutual interests in financial stability.⁸⁷ The Board's proposed ring-fencing approach, in contrast, creates the opposite incentives. We are concerned that if the Board "throws in the towel" on globally

⁸⁶ Federal Financial Analytics, *Banking by Border: Preventing Prudence from Turning into Protection in the New Financial Regulatory and Trade Framework* (Feb. 19, 2013) (describing the potentially protectionist features of the Proposal and a number of other U.S. and non-U.S. regulatory initiatives), available at http://www.fedfin.com/images/stories/client_reports/Petrou_Banking_by_Border.pdf.

⁸⁷ See, e.g., note 51 and associated text discussing the PRA's approach to liquidity management, which provides positive incentives for cooperation.

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coordinated home country-driven supervision of international banks, then other countries will follow.

Numerous government officials and industry observers have warned about the dangers of going down this path. For example, Michel Barnier, the European Commissioner for Internal Market and Services, recently described the implicit risks of the Board's Proposal:

I am not fully convinced by the proposed approach on Foreign Banking Organisation. It seems to me to be moving away from cooperation with international partners—a cooperation which I see as absolutely necessary. We need to work together with the [Board] on a proportionate and cooperative approach. . . . The EU and the US are at a crossroads. If we choose to part ways, this will send the wrong signal to markets and to the rest of the world. It would increase the cost of capital, and reduce growth prospects. If we can work together and cooperate, we can continue to provide a common base for international finance, boosting growth and employment.⁸⁸

Commissioner Barnier later expressed similar sentiments in a letter to Chairman Bernanke expressing serious concerns about the Proposal's potential repercussions:

We fear that the NPR could spark a protectionist reaction from other jurisdictions, which could ultimately have a substantial negative impact on the global economic recovery. Indeed, the potential retaliation effects of the new rules could end-up with a fragmentation of global banking markets and regulatory frameworks, with foreseeable consequences in terms of higher concentration of markets and lower levels of competition. These developments would translate into higher costs for banks, particularly those which are internationally active, with negative repercussions on their ability to finance the real economy and economic growth.⁸⁹

Mark Carney, Governor of the Bank of Canada, Chairman of the FSB and future Governor of the Bank of England, has made similar observations about trends towards ring-fencing:

Fearful that support from parent banks cannot be counted upon in times of global stress, some supervisors are moving to ensure that subsidiaries in their jurisdictions are resilient on a stand-alone basis. Measures to ring fence the capital and liquidity of local entities are being proposed. Left unchecked, these trends could substantially decrease the efficiency of the global financial system. In addition, a more balkanized system that

⁸⁸ Barnier Speech.

⁸⁹ Letter from Michel Barnier, European Commissioner for Internal Market and Services, to Chairman Bernanke, dated Apr. 18, 2013 (the "[Barnier Letter](http://www.federalreserve.gov/SECRS/2013/April/20130422/R-1438/R-1438_041913_111076_515131431183_1.pdf)"), available at http://www.federalreserve.gov/SECRS/2013/April/20130422/R-1438/R-1438_041913_111076_515131431183_1.pdf.

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concentrates risk within national borders would reduce systemic resilience globally.⁹⁰

Finally, Timothy Lane, Deputy Governor of the Bank of Canada, has also recently warned about the dangers of fragmentation and protectionism:

The issues I have raised, the cross-border dimensions of both financial instability and reform, could have another unintended result: that of a more fragmented global financial system. This tendency—as reflected, for example, in the decline in cross-border financing since the crisis—stems naturally from the greater perceived risks of cross-border financial activities, together with regulations that seek to protect domestic financial systems.

A reduction in cross-border interconnectedness may help to reduce contagion, but an unintended consequence could be excessive concentration and interconnectedness within countries. More generally, barriers to the movement of capital may carry a significant cost, in the form of lost economic efficiency and growth. From a global perspective, these considerations need to be balanced carefully.⁹¹

The Proposal does not reflect any meaningful consideration of these risks resulting from reciprocal measures by other countries, and does not cite any analysis or quantitative studies to suggest that the risks would not be serious. Indeed, the discussion of these risks—including implications for U.S.-headquartered banks operating abroad—at the Open Meeting of the Board at which the Proposal was approved was almost conclusory.⁹²

Based on the discussion at the Open Meeting and other statements, there appear to be two possible bases for the Board's conclusion that these risks—and potential implications for U.S.-headquartered banks operating abroad—are not a concern. First, the discussions have pointed out that the U.S. dollar is the world's reserve currency. In other words, the United States arguably can afford to take measures against the U.S. operations of foreign banks in a way that other countries cannot vis-à-vis U.S. banks because foreign banks are more dependent on U.S. dollar funding markets. In contrast, few U.S.-headquartered institutions have significant dependencies on funding markets in other currencies. To the extent this judgment is indeed part of the Board's basis for being comfortable with the international implications of its Proposal, it does seem to beg the question whether unilateral Board actions justified on this basis are consistent with the spirit of international commitments among the G20 countries and members of the Basel Committee. It also relies on a significant degree of confidence that—even following

⁹⁰ Mark Carney, Governor of the Bank of Canada, Rebuilding Trust in Global Banking, Remarks at the 7th Annual Thomas d'Aquino Lecture on Leadership, Richard Ivey School of Business, Western University, London, Ontario (Feb. 25, 2013), available at <http://www.bankofcanada.ca/2013/02/speeches/rebuilding-trust-global-banking/>.

⁹¹ Lane Speech (emphasis added).

⁹² See Meeting Transcript.

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an eventual European recovery and taking into account developments in Asian markets—the dollar will indefinitely retain its current strength as a global reserve currency.⁹³

Another basis that appears to underlie the Board’s conclusion that U.S.-headquartered banks would not be significantly affected by non-U.S. reciprocal measures is an assessment that such measures, even if taken, are unlikely to have a major impact on the profitability or safety and soundness of U.S.-headquartered institutions, or the ability to conduct an orderly resolution of U.S.-headquartered institutions. The quantitative analysis for this conclusion is not included in the record of the Proposal, however, and as a result we and other commenters are not able to respond to the factual basis for the conclusion.

When discussing the Proposal, Board Governors and staff have sometimes cited certain initiatives of foreign governments as being the same as, or similar to, the Proposal, in what appears to be an attempt to suggest that the United States is not the “first mover” towards a more fragmented and protectionist financial system.⁹⁴ It is not always clear what specific regulatory initiatives are being referenced in these statements, but it appears that the UK liquidity regulations noted above may be the most likely point of reference.⁹⁵ It is true that the FSA (now PRA) adopted liquidity regulations in 2009 that, as a default rule, would require firms operating in the UK through subsidiaries or branches to maintain local liquidity—to be “self-sufficient”. However, the UK liquidity framework has one critical difference when compared to the Proposal—the UK branches and subsidiaries of foreign firms can apply for waivers of the self-sufficiency requirement.⁹⁶ We understand that many such branches and subsidiaries have applied for and received such waivers.

The UK liquidity regulations would apply to both foreign and domestic firms in the UK, but even when the UK has proposed requirements that would focus solely on risks presented by foreign organizations, it has done so in a much less prescriptive and categorical manner, in stark contrast to the mandatory nature of the IHC requirement. The FSA’s consultation paper regarding how to address the risks to UK depositors of foreign bank national depositor preference schemes proposed subsidiarization as only one of many potential solutions

⁹³ See, e.g., Josh Noble, Australia to Buy Chinese Debt, Financial Times, Apr. 24, 2013 (noting trend of central banks to move reserves into renminbi).

⁹⁴ See, e.g., 77 Fed. Reg. at 76,631 (“several other national authorities have adopted modifications to or have considered proposals to modify their regulation of internationally active banks within their geographic boundaries”); Alex Barker and Tom Braithwaite, EU Warns US on Bank ‘Protectionism’, Financial Times, Apr. 22, 2013 (“A Fed spokesperson added: ‘The United Kingdom, the most comparable host country to the United States, has already required that subsidiaries of large foreign financial firms in London meet local capital and liquidity requirements.’”).

⁹⁵ See Strengthening Liquidity Standards, FSA Policy Statement 09/16 (Oct. 2009).

⁹⁶ See *id.* at 9 (“Under our new approach to intra-group and cross-border management of liquidity, the default position is that every UK legal entity and every UK branch must satisfy our quantitative requirements on a ‘self-sufficient’ basis—i.e. with no reliance on other parts of the group for liquidity purposes. However, branches and subsidiaries can apply for modifications from self-sufficiency, where the statutory tests within the Financial Services and Markets Act 2000 (FSMA) are met.”)

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to the issue, and would provide flexibility for foreign institutions to address the UK's concerns in a manner that is permissible and convenient under home country regulation.⁹⁷

The Proposal's IHC requirement is an outlier on the spectrum of international regulatory initiatives, imposing additional requirements on FBOs that go above and beyond the existing U.S. requirements that would otherwise apply relatively equally to subsidiaries of FBOs and U.S. BHCs alike. It would impose, solely on foreign organizations, a new structural requirement that separates local host country businesses from home country and other offshore business. It would super-impose, solely on foreign organizations, separate sub-consolidated capital and liquidity requirements in addition to capital and liquidity requirements already applicable to local IDIs, broker-dealers and functionally regulated firms. And it would not give FBOs flexibility to address the Board's prudential concerns in a manner more consistent with their individual regulatory environments, structures and activities.

In our view, U.S. efforts to increase financial stability would be far better directed towards bolstering international cooperation and coordination to ensure that all large, internationally active banking organizations are subject to robust and comparable consolidated home country supervision, rather than attempting to wall off the U.S. operations of FBOs from their operations in the rest of the world, thus risking reciprocal measures across the globe. At a minimum, however, the Board should either conduct an analysis of the impact on U.S. and global banks of other countries' adoption of reciprocal measures or—if the analysis has already been done—include the results of this analysis in the administrative record. These effects would not only be relevant to an evaluation of financial stability risks created by the Proposal but also to the cost-benefit analysis that we have suggested should be conducted.⁹⁸

9. *The Developments Cited by the Board Do Not Justify the Imposition of an IHC Requirement and the Trapping of Capital and Liquidity in the United States*

The preamble to the Proposal, as well as statements by Board Governors and Board staff, have identified a number of industry trends to justify the Proposal's dramatic changes in the Board's approach to the supervision and regulation of the U.S. operations of FBOs.⁹⁹ The operations of FBOs and U.S. BHCs alike have undoubtedly grown and evolved along with the global financial system over the past several decades, and the IIB agrees that the regulation of financial services generally failed to keep pace in the years prior to the financial crisis. The IIB strongly supports the continuing efforts of the Board and other U.S. and non-U.S.

⁹⁷ See, e.g., FSA, Addressing the Implications of Non-EEA National Depositor Preference Regimes, Consultation Paper CP 12/23 (Sept. 2012) (not requiring subsidiarization, nor mandating any particular solution to the issue of subordination of UK depositors at branches of non-UK banks; stating instead that "firms will be able to adopt other measures provided that they can demonstrate that these are equally effective" and, indeed, including a whole section discussing suggested "other possible measures"). See also notes 124 to 130 above and accompanying text (discussing UK and other "ringfencing" initiatives).

⁹⁸ See Part I.A.6 above.

⁹⁹ See 77 Fed. Reg. at 76,629 – 31. See also Tarullo Speech; Meeting Transcript; Dollar Funding and Global Banks, Speech by Governor Jeremy C. Stein at the Global Research Forum, International Finance and Macroeconomics, (Dec. 17, 2012), available at <http://www.federalreserve.gov/newsevents/speech/stein20121217a.htm>.

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regulators to enhance U.S. and global financial stability through robust supervision and regulation—including the appropriate implementation of Section 165. However, in our view none of the trends identified by the Board justifies the Proposal’s extraordinary departure from long-standing U.S. policy towards FBOs, nor would they justify the adverse effects on the U.S. economy and U.S. financial stability that could result if the Board were to implement the Proposal in its current form.

(a) The Changing Risks to U.S. Financial Stability Presented by FBOs

According to the Board’s narrative, until relatively recently, the U.S. operations of FBOs were largely net recipients of funding from their parent institutions and their activities were generally limited to traditional lending to home country and U.S. clients.¹⁰⁰ Although their U.S. operations expanded steadily during the decades up through the 1990s, the Board states that overall they posed only limited risks to U.S. financial stability. However, the Board claims that the profile of FBOs in the United States changed substantially in the years that followed. The Proposal describes a shift among the U.S. operations of FBOs away from U.S. lending activities funded by home offices and towards U.S. fundraising for activities abroad, leading to an increased reliance on short-term U.S. dollar wholesale funding. In addition, the Proposal states that the U.S. operations of the largest FBOs—much like the largest U.S. BHCs—have become increasingly concentrated, interconnected and complex since the mid-1990s, and have significantly expanded their trading and capital markets activities. The Proposal identifies these changing risks as one justification for its new approach to FBO regulation.

However accurate this description of FBO operations in the United States may be in the aggregate, it fails to account for the wide diversity of FBO business models. Many FBOs do not rely on their U.S. branches as a net source of U.S. dollar funding for their non-U.S. operations. In addition, during the 2011 Eurozone crisis, significant funding flowed into the United States from Europe to make up for reductions in wholesale funding available for EU bank branches in the United States.¹⁰¹

Among those FBOs that do use their U.S. operations to source U.S. dollars for their non-U.S. operations, the relative importance of an FBO’s U.S. operations to its business plans and revenue streams are key factors in determining how the FBO would support its U.S. operations in a time of stress.¹⁰² Moreover, the increases in concentration, interconnectivity and complexity described by the Board are not equally spread among all FBOs. Instead, these increases are concentrated in the few FBOs (each a SI-FBO) that, like the largest U.S. BHCs, have grown to become part of the select group of financial institutions whose global commercial and investment banking operations have developed in connection with, and provide critical financial intermediation for, the increasingly interconnected world economy.

¹⁰⁰ See 77 Fed. Reg. at 76,629 – 30.

¹⁰¹ See Joseph Abate, Downstreaming and Money Funds, Barclays Research Report (2013). See also notes 71 above and 105 below.

¹⁰² See, e.g., Nicola Cetorelli and Linda Goldberg, Liquidity Management of U.S. Global Banks: Internal Capital Markets in the Great Recession, Federal Reserve Bank of New York Staff Report No. 511 (describing how a parent bank hit with a funding shock will reallocate liquidity according to a “locational pecking order” based on the importance of the affiliate or branch for the parent bank’s revenue).

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Indeed, although FBOs as a whole play an important role in the U.S. economy, their importance to U.S. financial stability pales in comparison to the importance of the largest U.S. BHCs, as demonstrated by the evidence of league tables; the FBO share of U.S. lending, trading and derivatives activities; and the experience of the recent financial crises.¹⁰³ To our knowledge, none of the studies of the causes of the U.S. financial crisis have pointed to the U.S. operations of FBOs as a disruptive force or significant contributing factor.¹⁰⁴ And evidence shows that many European banks stepped in to provide funding to their U.S. operations when their access to wholesale U.S. dollar funding came under pressure in the midst of the Eurozone banking crisis of 2011, mitigating the effects of the Eurozone crisis on FBO lending in the United States.¹⁰⁵

The Proposal's narrative of the period leading up to and during the financial crisis also omits the role that FBOs played in transactions that directly supported U.S. financial stability, acquisitions of failed bank and nonbank operations of financial companies in the United States, participation in FDIC resolution transaction auctions and equity investments in major financial companies. FBOs engaged in many of these transactions with fundamental expectations about the U.S. supervisory and regulatory standards that would apply to their cross-border U.S. operations in the future, expectations that would be severely disrupted if the Board were to adopt the Proposal in its current form.

Furthermore, it is highly questionable whether the Proposal's IHC requirement—which in many ways represents a modified form of mandatory subsidiarization as applied to nonbank affiliates in the aggregate—would have provided any benefit to the United States or globally during the financial crisis. As observed by a recent IMF staff paper on the choice between branches and subsidiaries: “[T]he problems experienced by cross-border banking groups during the recent crisis had little, if anything, to do with whether they were legally organized as branches or subsidiaries, and had much to do with the underlying weaknesses in risk management, regulation and supervision, supervisory coordination, and crisis management tools.”¹⁰⁶

¹⁰³ Although FBOs play a significant role in the U.S. financial markets, their presence is dwarfed by the largest U.S. institutions. For example, the four leading U.S. loan bookrunners are all U.S. BHCs, and their aggregate volume for 2012 was \$856 billion, more than three times the loan volume accounted for by the five FBOs in the top ten. See note 72 and accompanying text above.

¹⁰⁴ See, e.g., Financial Crisis Inquiry Commission (“FCIC”), Financial Crisis Inquiry Report (Jan. 2011) (discussing at length role and experiences of U.S. firms in the financial crisis that began in 2007); CGFS, Long-term Issues in International Banking, CGFS Papers No. 41 (July 2010) (discussing findings that foreign bank activities in a country “lead to less procyclical lending behavior” and that “local lending by foreign banks was more stable during the recent crisis than cross-border lending, which depends to a greater extent on the health of the parent institution.”).

¹⁰⁵ See, e.g., Ricardo Correa, Horacio Sapriza and Andrei Zlate, Liquidity Shocks, Dollar Funding Costs and the Bank Lending Channel During the European Sovereign Crisis, Board International Finance Discussion Paper 2012-1059 (Nov. 2012) (describing how parent banks and other offices of Eurozone FBOs provided financial support to their U.S. branches after money market funds and other large time depositors withdrew funding for U.S. branches of Eurozone banks during the Eurozone crisis).

¹⁰⁶ Jonathan Fiechter, İnci Ötker-Robe, Anna Ilyina, Michael Hsu, André Santos, and Jay Surti, Subsidiaries or Branches: Does One Size Fit All? IMF Staff Discussion Note SDN/11/04 (Mar. 7, 2011).

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Given the diversity of FBOs operating in the United States and the fact that only a few of those FBOs have the potential to be systemically important to U.S. financial stability, it would be an extraordinary overreach to impose the IHC requirement categorically on more than two dozen FBOs. We also question the wisdom of taking such a major step to restructure the regulation of foreign banking in the United States based only on the lessons of the recent crisis, given that the patterns the Board has described are continuing to evolve, and the structure the Board perceives as ideal for the financial crisis may not be effective in preventing—or may even exacerbate—trends in a future crisis. At the same time, we recognize that the largest U.S. and non-U.S. banking organizations have indeed become more concentrated, interconnected and complex over the last ten to fifteen years, and the IIB supports a balanced approach to addressing the unique risks to financial stability that SIFIs may present.

The statutory mandates in Section 165, and Dodd-Frank more generally, require the Federal Reserve, FSOC and the other prudential regulators to focus their efforts on addressing the greatest sources of systemic risk to the U.S. financial system and economy, while giving due regard to the principle of national treatment and competitive equality and taking into account comparable consolidated home country supervision. The Proposal’s categorical approach to an IHC requirement fails to accomplish these goals. Taking a tailored approach to the regulation of FBOs and U.S. BHCs based on the relative risks those institutions present to the United States, as outlined in the SI-FBO Framework described below, would enable the Board to more effectively address the potential risks to U.S. financial stability presented by the operations of SI-FBOs while also giving due effect to the Board’s statutory mandates.

(b) Lack of Complete Firsthand Information Regarding the Global Risk Profile of FBOs

The Proposal also raises a concern that U.S. supervisors, as host country supervisors, have less access to timely information on the global operations of FBOs than to similar information on U.S. BHCs. As a result, the Proposal suggests that the “totality of the risk profile” of the U.S. operations of a FBO can be “obscured” when those operations are used to fund activities outside the United States, thereby increasing risk—or at least uncertainty about the extent of risk—to the U.S. financial system. As explained in our White Paper, the IIB understands that adopting a tailored approach to systemic risk supervision of FBOs and U.S. BHCs alike will require the Board to make assessments of the systemic risk profile of supervised institutions, and that as a result it may be necessary for supervised institutions and their home country supervisors to provide the Board with information of greater detail and broader scope than has traditionally been required under the Board’s consolidated supervision of U.S. BHCs and the U.S. operations of FBOs.

Although there are inherent information limitations in the Board’s role as a host country supervisor, these limitations do not justify abandoning the Board’s long-standing principle that international financial institutions should be supervised on a global, consolidated basis—a principle affirmed in Section 165. Under the tailored SI-FBO Framework described below, the Board would retain full access to all information regarding an FBO’s U.S. operations through its current direct oversight of those operations and its significantly expanded

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examination authority under Dodd-Frank.¹⁰⁷ Insight into the risk profile of a SI-FBO's global activities would come from the Board's evaluation of the home country supervisory framework and standards applicable to the FBO, and from firm-specific information available from home and other host country supervisors and the FBO itself. To the extent the Board faces resistance to its information requirements or continues to believe that the information it is receiving is inadequate, it can condition relief from certain requirements on the provision of satisfactory information to the Board.¹⁰⁸

The FSB and the Basel Committee have recently strengthened programs designed to confirm that prudential standards are implemented consistently across jurisdictions, which should give the Board additional assurance that the information it receives as a host supervisor will be adequate.¹⁰⁹ Information sharing through firm-specific crisis management groups is another key area of international cooperation and should also provide the Board with high-quality information on the global risk profile and strength of SI-FBOs. Although the framework for crisis management groups, supervisory colleges, and other international collaboration continues to evolve, the IIB believes that cross-border information sharing regarding SIFIs must become comprehensive and vigorous. Indeed, without effective cooperation and information sharing, supervisors may fail to detect emerging systemic risks, as each focuses solely on its limited sphere of influence.

The Board should focus on building the relationships, systems and understandings necessary to achieve effective international cooperation and timely access to information, rather than adopting regressive, protectionist measures premised on the assumption that cooperation and coordination are doomed to fail. It would be seriously premature to require FBOs to restructure their U.S. operations while these efforts are ongoing, and likely counter-productive from the perspective of encouraging greater cross-border information sharing. Ultimately, the Board's concerns regarding the risks presented by FBO activities are global issues, best solved through global cooperation.

(c) The Need to Minimize Destabilizing Procyclical Ring-Fencing in a Crisis

The Proposal cites the dangers of “destabilizing procyclical ring-fencing” as another justification for the IHC requirement. In particular, it points to the failures of several international banking organizations during the financial crisis in which capital and liquidity

¹⁰⁷ See notes 157 to 159 and accompanying text below.

¹⁰⁸ The PRA has taken a similar approach in its liquidity regulations for the UK operations of foreign financial institutions, wherein it will permit a UK branch or subsidiary of a foreign financial institution to obtain modifications to the PRA's liquidity “self-sufficiency” requirement that lift the default requirement to hold a local operational liquidity reserve, provided the UK branch or subsidiary, its parent and its home country supervisor satisfy certain ongoing conditions, including home country supervisory equivalence and cooperation and adequate access to information. See Strengthening Liquidity Standards, FSA Policy Statement 09/16. As noted earlier, we understand that many firms operating in the UK have applied for and received modifications. See note 51 above.

¹⁰⁹ See notes 42 to 45 and accompanying text above.

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related to overseas operations were trapped at their home offices during their resolutions.¹¹⁰ The Board uses this example to posit that “centralized management of capital and liquidity can promote efficiency during good times, [but] it can also increase the chances of home and host jurisdictions placing restrictions on the cross-border movement of assets at the moment of a crisis, as local operations come under severe strain and repayment of local creditors is called into question.”¹¹¹

We agree, of course, that the geographical trapping of capital and liquidity during a time of crisis can have procyclical effects on an institution’s operations and creditors in other jurisdictions, and potentially worsen a crisis in those jurisdictions. However, the Board’s proposed remedy—a blanket requirement for FBOs to trap capital and liquidity in the United States ex ante—could just as well have its own negative procyclical effects on financial stability, as it reduces an FBO’s flexibility to respond to stress in other parts of the organization on a continual basis.

The Proposal discounts the value of flexibility to move capital and liquidity during a crisis from jurisdictions which are relatively stable, and where funding can be raised at relatively low cost, to jurisdictions where the greatest need for capital and liquidity arise.¹¹² Trapping pools of capital and liquidity in local jurisdictions would not only have a contractionary effect on the supply of credit during the global economic recovery, but it would also hinder the ability of many international banks to react to future crises with coordinated, centralized responses.¹¹³ Although some FBOs have chosen to organize their cross-border operations in the United States in a manner consistent with the Proposal—in general, the decentralized model appears to be preferred among FBOs focused on commercial retail banking with local FDIC-insured deposit funding—others rely more heavily on centralized funding, capital and liquidity

¹¹⁰ The Proposal names only one example of this phenomenon, the failure of Icelandic banks during the crisis. See 77 Fed. Reg. at 76,630 (“For example, the Icelandic banks held significant deposits belonging to citizens and residents of other countries, who could not access their funds once those banks came under pressure.”). We would respectfully suggest that whatever other lessons the Icelandic banking crisis may teach, it is not clear that they bear on the merits of a structural subsidiarization approach like the IHC requirement.

The other example that has been cited in this context is the bankruptcy of Lehman Brothers and the failure of certain of its operating entities. The implications of the Lehman Brothers bankruptcy for the debate over subsidiarization are similarly unclear, not least because Lehman Brothers’ principal relevant entity in the United Kingdom was a separately incorporated subsidiary.

¹¹¹ Id.

¹¹² The Proposal notes that “some foreign banking organizations were aided by their ability to move liquidity freely during the crisis” but asserts that the resulting “cross-currency funding risk and heavy reliance on swap markets” proved to be destabilizing. As noted above, the preamble does not elaborate on the actual destabilizing effects that reliance on swaps markets created, and it does not place a relative value on the flexibility to move liquidity as compared to the associated risks. See 77 Fed. Reg. at 76,630; note 71 above. See also CGFS, Funding Patterns and Liquidity Management of Internationally Active Banks at 33 (“The ability to shift funds across jurisdictions was an important instrument of crisis management for many international banks.”).

¹¹³ See CGFS, Funding Patterns and Liquidity Management of Internationally Active Banks at 18, 33 – 34.

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management.¹¹⁴ Mandatory local requirements such as those set forth in the Proposal, if imposed by the United States and other jurisdictions, therefore likely would have destabilizing procyclical effects during a crisis, as liquidity and capital would be hoarded for local home and host country obligations. We would also expect such local requirements to increase the need for FBOs to take advantage of “lender of last resort” government credit facilities, as banks with relatively centralized liquidity management lose the ability to efficiently move liquidity to the branches or operations that need it most. Indeed, the Proposal could accelerate the withdrawal of FBOs from the U.S. markets in the event of a crisis at their home jurisdictions, because the liquidity and capital costs of maintaining U.S. operations would be higher and harder to justify when assets are needed elsewhere.

The Board should reserve such extreme measures for those specific situations in which the totality of the facts and circumstances indicate that the benefits of trapping capital and liquidity locally clearly outweigh the costs of doing so.

(d) Impediments to Effective Cross-Border Resolution

Despite continuing efforts by U.S. and international regulators to work towards common understandings and mechanisms for the resolution of large cross-border financial institutions, the Board appears to remain skeptical about their ultimate effectiveness, and the Proposal cites the complexity of cross-border resolution as another justification for the Board’s new approach. Although many challenges and complexities undoubtedly would be involved in the insolvency and resolution of a large, internationally active banking organization, we believe the Board should not prejudge efforts at international coordination as failures. National regulators and international bodies are actively exploring the viability and operational impediments to effective resolution of large, internationally active financial institutions, and are exploring multiple models for resolutions. Currently, the general trend suggests that a single-point-of-entry resolution conducted at the top-tier holding company of a global consolidated entity is likely to be the favored resolution strategy for many internationally active financial institutions.¹¹⁵ Some institutions operating according to a decentralized model—where key subsidiaries in different jurisdictions operate more or less independently from the ultimate parent company—are more suited for a coordinated multiple-point-of-entry resolution.¹¹⁶ In either case

¹¹⁴ See, e.g., Leonardo Gambacorta and Adrian van Rixtel, Structural Bank Regulation Initiatives: Approaches and Implications, BIS Working Papers No. 412 at 7 (Apr. 2013) (classifying G-SIBs as one of four overall business models: specialized investment banking, investment banking-oriented universal banks, commercial banking-oriented universal banks, and specialized commercial banks).

¹¹⁵ See, e.g., FDIC and Bank of England, Resolving Globally Active, Systemically Important, Financial Institutions at 11 (Dec. 10, 2012) (the “[FDIC-BoE Report](#)”) (“It should be stressed that a key advantage of a whole group, single point of entry approach is that it avoids the need to commence separate territorial and entity-focused insolvency proceedings, which could be disruptive, difficult to coordinate, and would depend on the satisfaction of a large number of pre-conditions in terms of structure and operations of the group for successful execution. Because the whole group resolution strategies maintain continuity of business at the subsidiary level, foreign subsidiaries and branches should be broadly unaffected by the resolution action taken at the home holding company level.”).

¹¹⁶ See FSB, Recovery and Resolution Planning: Making the Key Attributes Requirements Operational (Nov. 2012) (discussing criteria for effective “single-point-of-entry” and “multiple-point-of-entry” resolutions); International Institute of Finance, Making Resolution Robust—Completing the Legal and Institutional

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coordination and cooperation among jurisdictions appears to be essential, and we encourage the Board to work closely with its global counterparts to address the challenges it perceives in the process of resolving a cross-border banking organization.¹¹⁷

As the largest economy in the world, home to the deepest and most liquid financial markets, a signal from the Board that the United States lacks faith in international cooperation on resolution will discourage other jurisdictions from pressing forward, to the overall detriment of global stability. By designing a structure expressly intended to facilitate the “resolution or restructuring of the U.S. subsidiary operations” of an FBO, the Board is effectively informing the world that it lacks confidence in one of the two main approaches proposed to date, and moreover appears to lack confidence in the basic idea of cross-border cooperation in a resolution scenario.¹¹⁸

Not only would the Proposal signal a lack of faith in international efforts regarding cross-border resolution planning, it would also create counterproductive incentives and impose significant practical impediments to single-point-of-entry resolution. Trapping capital and liquidity in local jurisdictions would reduce the resources available to a home country regulator triggering a bail-in style resolution of a global SIFI. As each jurisdiction moves to trap capital and liquidity locally, they would reduce incentives to cooperate on a global resolution, and could, perversely make a cascading failure across multiple jurisdictions more likely. The specter of a host country regulator independently triggering a resolution of a SIFI’s local operations without full consideration of alternatives and of extraterritorial effects would increase the likelihood that other regulators would perceive a need to act first.¹¹⁹ Commissioner Barnier highlighted these very concerns in his April 18 letter to Chairman Bernanke, warning that:

The “territorial” approach, as proposed in the NPRs, has a ring-fencing effect, which, besides fragmenting the global banking activity, also affects cooperation among regulators in the resolution of cross-border institutions. Such cooperation is essential not only in the implementation of the resolution strategies but also in their design. Trust among regulators is therefore essential to ensuring more efficient and effective resolution plans and living wills.

This “territorial” approach, in particular if replicated by other regulators, would instead preclude the possibility to resolve a G-SIFI in its entirety in

Frameworks for Effective Cross-Border Resolution of Financial Institutions (June 2012) (describing the different resolution strategies that may apply depending on whether a financial group is integrated or decentralized).

¹¹⁷ See also. Orderly Resolution of SIFIs with Extensive Cross-border Operations, Remarks by FDIC Chairman Martin J. Gruenberg at the Annual Washington Conference of the IIB (Mar. 4, 2013), available at <http://www.fdic.gov/news/news/speeches/spmar0413.html>.

¹¹⁸ 77 Fed. Reg. at 76,637 (emphasis added).

¹¹⁹ See, e.g., Duncan Wood, US Foreign Bank Plans threaten Bail-in System, Says Finma, Risk Magazine (Apr. 5, 2013) (“The danger of this multiple-entry approach, where everyone looks after their own entities, is that it very quickly triggers an uncontrolled sequence of defaults on a global basis”) (interview with Mark Branson, head of banks division at Finma, the Swiss national prudential regulator).

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a coordinated manner among different national authorities in accordance with the single point of entry strategy. This is clearly in contradiction with the international standards on cross-border cooperation in bank resolution adopted by the Financial Stability Board and endorsed by the G20.¹²⁰

As Commissioner Barnier observes, this result would be inconsistent with the FSB Resolution Framework, which evidences a clear preference for coordinated resolutions led by an institution's home country regulator, and counsels host jurisdictions considering independent national action "in exceptional cases" to consider extraterritorial impacts and to give prior notice to and consult with home country authorities before taking action.¹²¹

Even if the Board were correct in discounting the likelihood of success of these international efforts, its proposed remedy would be too broad in scope and too categorically applied. The Board and the FDIC have the tools in the resolution planning process to review an FBO's resolvability and to require changes—including structural changes—in those instances where an FBO's resolution plan is not credible. There is no need to take a categorical approach at this juncture when the Board can take an approach more finely calibrated to the actual difficulty of resolving any particular FBO on a coordinated basis and to the likelihood of systemic consequences should that FBO fail.¹²² The degree of cooperation available from home country regulators would be a key consideration.

(e) Limitations on Parental Support in a Time of Crisis

The Proposal asserts that one of the "fundamental elements" of the Board's traditional approach to FBO supervision—its ability to rely on parent FBOs to serve as a source of strength for their U.S. operations—is in doubt, pointing to certain other jurisdictions that have modified, or are considering modifying, their regulation of internationally active banks to impose some form of local liquidity requirements or ring-fencing within their geographic boundaries.¹²³ The Board asserts that these changes to home country law would constrain an FBO's ability to provide support to its foreign operations, and that as a consequence of the financial crisis, home country governments of large FBOs are now less likely to backstop their banks' foreign operations.

We do not disagree with the basic proposition that home country legal regimes, including home country recovery and resolution planning standards, ring-fencing of activities,

¹²⁰ See Barnier Letter.

¹²¹ See FSB Resolution Framework at 13. Consistent with the FSB Resolution Frameworks, Section 210 of the Dodd-Frank Act requires the FDIC to "coordinate, to the maximum extent feasible" with foreign regulatory authorities in the event of a resolution of an internationally active SIFI. Dodd-Frank § 210(a)(1)(N).

¹²² We note that the Board and FDIC have yet to receive, much less begin to review, the initial resolution plans that will be filed by the vast majority of FBOs that would be affected by the Proposal.

¹²³ See 77 Fed. Reg. at 76,631 ("Modifications adopted or under consideration include increased requirements for liquidity to cover local operations of domestic and foreign banks and nonbanks, limits on intragroup exposures of domestic banks to foreign subsidiaries, and requirements to prioritize or segregate home country retail operations.").

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etc., are relevant to the Board's analysis of systemic risk under Section 165. We disagree, however, with the conclusions that are drawn in the Proposal from the Board's observations. This is mainly because in our view home country legal (or political) developments like those mentioned by the Board must be viewed in the overall context of factors that would determine an FBO's practical ability to support its U.S. operations, even in a time of crisis.

When evaluating an FBO's ability to support its U.S. operations, the Board should look first to the financial strength of the parent company. A highly capitalized and liquid parent is the strongest indicator of availability of parental support. The Proposal's one-size-fits-all approach would generally disregard differences in parental strength, except in the application of remediation measures for FBOs that allow their consolidated capital to fall below the Board's capital-based remediation triggers. Basing a regulatory scheme on the likelihood of support in the event of a failure without any consideration for the likelihood of failure seems to us grossly unfair, and it fails to give incentives for FBO parents and their regulators to maximize the safety and soundness of the parent institution.

In connection with assessing the financial strength of the parent company, the Board should take into account the steps that other jurisdictions are taking to improve the viability of FBOs through significantly heightened capital requirements and other enhanced measures. Jurisdictions around the world are taking steps to improve the financial strength, viability and resiliency of their home country financial institutions. The Board should encourage these developments by taking these new, more stringent regulatory standards into account—both in terms of the protective nature of enhanced regulation, which will make it less likely for a jurisdiction's banks to become troubled, and in terms of the actual enhanced financial strength of FBOs subject to these standards. These evolving proposals should be judged on a jurisdiction-by-jurisdiction, institution-by-institution basis, in the context of the full range of home country supervisory measures, so the Board can come to an informed conclusion about the implications of each jurisdiction's changing laws for the systemic importance of an FBO to the U.S. financial system.

The Board should also take into consideration the real reputational and legal consequences of permitting a subsidiary in a host country to fail, consequences that make support of foreign operations an imperative for FBOs and their home country supervisors. If an FBO (or its home country) allowed its operations to fail in the United States or another major international capital markets locale, it would likely bring the entire enterprise to the brink of collapse. In a crisis, when the institution is already in a potentially weakened state and the markets are sensitive to any sign of risk, such a signal could be a death-knell for the institution globally.

Although some jurisdictions may, for political reasons or simple reasons of scale, appear less able to provide support to their largest banks, other jurisdictions will face no such barriers, and the imminent failure of a major player in a home country's economy would focus the minds of even those jurisdictions that appear least likely to provide support. Indeed, given the relative scale and importance of banks in many other countries, and the lack of tested resolution or orderly liquidation regimes in many of those countries, rescue transactions and measures generally remain the least-worse choice between two admittedly bad options, at least until effective cross-border resolution regimes can be developed. Rather than making a blanket

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assessment of the availability of parental and home country support, the Board should include an individualized assessment as one of many factors it looks to when evaluating a an FBO’s global resources and regulatory context.

Finally, the Board asserts that certain proposed home country modifications to the regulation of international banks may constrain the ability of a parent to support its U.S. operations. In support for this proposition, the Board cites two jurisdictions which are actively working to strengthen their regulation of financial institutions, the UK and Switzerland.¹²⁴ Although it is true that these jurisdictions have proposed reforms that would provide additional protection or separation for domestic retail banking activities, they have not proposed a complete cut-off of support from the parent organization to its foreign operations. Rather, these proposals merely identify certain critical domestic activities that would be protected in a failure and/or segregated from other, more “risky” and less “important” activities.¹²⁵ Indeed, many of the features the Board cites as matters of concern—such as the limits on intragroup exposures of domestic banks to foreign subsidiaries, and requirements to segregate home country retail operations from “riskier” investment banking activities—appear to closely resemble the restrictions on IDIs currently in force under U.S. law.¹²⁶

For example, proposals by the Independent Commission on Banking (commonly known as the Vickers report) in the UK were based on a call to reconsider the impact of wholesale and investment banking operations on domestic retail business, similar to concepts that led to the passage of the Volcker Rule.¹²⁷ Similarly, proposals from the EU’s High-level Expert Group on reforming the structure of the EU banking sector (commonly known as the Liikanen report) aim to separate certain perceived riskier activities from certain more

¹²⁴ See 77 Fed. Reg. at 76,630 – 31 and n. 13 (citing proposed and final regulatory reforms in the UK and Switzerland).

¹²⁵ See, e.g., Leonardo Gambacorta and Adrian van Rixtel, Structural Bank Regulation Initiatives: Approaches and Implications, BIS Working Papers No. 412 (Apr. 2013) (describing various structural reform initiatives in advanced economies, including the United States, UK, Germany, France and the EU, intended to “insulate certain types of financial activities regarded as especially important for the real economy . . . from the risks that emanate from potentially riskier but less important activities” by drawing a line “somewhere between ‘commercial’ and ‘investment’ banking”). See also FDIC-BoE Report at 9 (“[O]ne of the advantages of the ringfence [of retail deposit-takers] which is being introduced in the U.K. [is that it] will provide flexibility in the event of fatal problems elsewhere in the group to transfer the ringfenced entity to a bridge bank or purchaser in its entirety. If losses were concentrated in the ringfenced entity and capital in the ringfenced entity was insufficient to absorb them, then losses could be borne by creditors of the ringfenced bank (including debt holders where the ringfenced bank had issued debt into the market).”).

¹²⁶ See, e.g., 12 U.S.C. §§ 371c and 371c-1 (Sections 23A and 23B of the Federal Reserve Act); the Board’s Regulation W, 12 C.F.R. Part 23; 15 U.S.C. §§ 78c(a)(4) and 78c(a)(5) (GLBA broker-dealer “push-out” provisions); 12 U.S.C. § 24(Seventh) (activity restrictions on national banks); 12 U.S.C. §§ 601 and 618 (limitations on amounts permitted to be invested in entities engaged in international or foreign banking); 12 C.F.R. § 211.5(h)(1) (same). See also, e.g., Dodd-Frank § 619 (the “Volcker Rule”); notes 94 to 97 above and accompanying text.

¹²⁷ See, e.g., Financial Services (Banking Reform) Bill, 2012-13, Bill [130] (UK) (introduced Feb. 4, 2013); UK Independent Commission on Banking, Final Report: Recommendations (Sept. 2011).

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“traditional” banking business by causing them to be placed in separate subsidiaries.¹²⁸ German and France initiatives are also focused on separating certain trading activities from other businesses.¹²⁹ Other initiatives to enhance capital and liquidity requirements in local jurisdictions also appear to be similar to the current capital and liquidity requirements already imposed on U.S. IDIs and broker-dealers, whether or not they are owned by U.S. or foreign firms. Most of these proposals are still in their proposed forms, or in various stages of development and consideration.¹³⁰ Consequently, in our view it would be premature to adopt a U.S. policy response based on predictions regarding their ultimate design and implications.

In addition, as noted above, the Board should take in account the other measures these jurisdictions have taken to strengthen their domestic SIFIs. Indeed, in the last several years, various proposals, including the ones cited by the Board, maintain, or increase, robust home country capital, liquidity and risk management requirements for the entire organization, including for businesses separated from the domestic retail business. Often such requirements are intended to be consistent with strengthened international standards in an effort to maintain competitiveness of the separated businesses. The likelihood of support for a failing institution should be balanced against the likelihood that the institution could require support in the first place.

Rather than making a blanket judgment about the ability of SI-FBOs and their home country governments to support their U.S. operations, the Board should assess the actual legal and regulatory framework and the strength of the FBO’s global consolidated operations before imposing U.S.-specific requirements.

(f) Concerns Regarding Capital Adequacy of U.S. Broker-Dealer Subsidiaries

Most if not all FBOs that might reasonably present risks to U.S. financial stability on a scale within the contemplation of Section 165 conduct significant investment banking operations in the United States through one or more SEC-registered broker-dealer affiliates. These affiliates typically engage in a range of securities-related activities, including market-making, M&A advisory, brokerage, custody and clearing services. Broker-dealer affiliates also participate in derivatives, futures and commodities markets. The capital adequacy and liquidity of a broker-dealer is subject to supervision and regulation by the SEC and the Financial Industry Regulatory Authority (“FINRA”), and the exposures of an FBO’s broker-dealer affiliate are also subject to consolidated capital and liquidity requirements at the

¹²⁸ See High-level Expert Group on Reforming the Structure of the EU Banking Sector, Final Report (Oct. 2, 2012).

¹²⁹ See Draft Bill on the Separation of Risks and Recovery and Resolution Planning for Credit Institutions and Banking Groups (published Feb. 6, 2013) (Germany); Draft Law Regarding the Separation and Regulation of Banking Activities (presented Dec. 19, 2012) (France).

¹³⁰ One exception is the final revised PRA liquidity regime, which requires UK branches and subsidiaries of foreign financial institutions to be “self-sufficient” as a default rule. In practice, the UK has generally waived the self-sufficiency requirement in favor of deferring to home country regulation so long as the UK is satisfied with the quality of information it receives regarding a firm’s whole bank liquidity. See notes 51 and 108 above.

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level of the FBO parent. FBO broker-dealer affiliates are fully subject to BHC Act activities restrictions inside the United States, including the prohibition on “proprietary trading” introduced by the Volcker Rule.

Although the Proposal only briefly mentions FBO broker-dealer affiliates in laying the groundwork for the IHC requirement, concerns regarding the growth and leverage of the U.S. broker-dealer affiliates of the largest FBOs are plainly central issues motivating the proposed approach. Both the Proposal and Governor Tarullo’s speech that preceded its release make a point of noting that “[f]ive of the top-ten U.S. broker-dealers are currently owned by [FBOs.]”¹³¹ In his speech, Governor Tarullo went on to note that “[l]ike their U.S.-owned counterparts, large foreign-owned U.S. broker-dealers were highly leveraged in the years leading up to the crisis” and that “[t]heir reliance on short-term funding also increased, with much of the expansion of both U.S.-owned and foreign-owned U.S. broker-dealer activities attributable to the growth in secured funding markets during the past 15 years.”¹³²

It is also clear from the content and logic of the IHC requirement that it is primarily targeted at FBOs’ U.S. broker-dealer affiliates, as U.S. bank subsidiaries are already fully subject to U.S. capital regulation. Following implementation of the Collins Amendment, an intermediate BHC between an FBO and its U.S. bank subsidiary will be subject to U.S. capital regulation. Consequently, the IHC concept must be designed to impose U.S. bank regulatory capital requirements on an FBO’s U.S. nonbank affiliates that are not owned in a U.S. bank or BHC chain—either because the FBO does not own a U.S. BHC or because it owns the relevant U.S. nonbank affiliates in a separate chain of ownership. And because the most significant U.S. nonbank affiliates of FBOs (in terms of potential financial stability risks) are broker-dealers and—to a lesser degree—other functionally regulated entities such as investment advisors and insurance companies, it stands to reason that the U.S. broker-dealers are the focus of the IHC requirement, especially as it relates to bank regulatory capital requirements.¹³³ The preamble to the Proposal supports this conclusion without stating so directly, by observing that the Proposal would “strengthen the capital position of U.S. subsidiaries of [FBOs]”.¹³⁴

The IIB understands that the Board views the leverage of U.S. broker-dealers as having been a major contributing factor to the severity of the financial crisis and a continuing source of potential systemic risk in the United States. However, the Board’s perception that broker-dealers operate with too much leverage does not justify the imposition of bank regulatory capital standards on nonbank businesses affiliated with FBOs, especially when the Board has avoided any explicit finding that the capital levels of broker-dealers in general, or of those associated with FBOs in particular, present a systemic risk to U.S. financial stability. Furthermore, the Proposal fails to acknowledge that broker-dealer subsidiaries of FBOs are subject to the bank regulatory capital standards of their home countries, as supplemented and enhanced by Basel III. Absent a finding that an FBO’s capital and capital planning are

¹³¹ 77 Fed. Reg. at 76,630; Tarullo Speech.

¹³² Tarullo Speech.

¹³³ See Oliver Wyman Study at 21 (“Effects of the proposed rule will be felt most acutely by FBOs with major broker-dealers”).

¹³⁴ 77 Fed. Reg. 76,640 (emphasis added).

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inadequate, or that an FBO's home country implementation of internationally agreed standards is deficient, there should be no need to impose U.S. bank capital rules on an FBO's U.S. broker-dealer.

The business model of a broker-dealer is fundamentally different than that of a commercial bank or an FBO's U.S. branches, and the risks presented by a U.S. broker-dealer affiliate are fundamentally different than the risks presented by a commercial bank affiliate or branch of an FBO. Traditional commercial banking organizations are primarily in the business of maturity transformation, generating profits from the spreads between short-term and long-term interest rates, fees for commercial and retail banking services, etc. and primarily manage credit risk, while traditional broker-dealer operations primarily manage market risks and advise and facilitate customer transactions, typically relying on the fees and spreads available to intermediaries, trading parties and advisors to generate profits. As a result, the assets acquired, held and sold by a broker-dealer are generally liquid securities, while loans and other traditional bank assets are far less liquid.¹³⁵ In addition, broker-dealers' assets and liabilities are largely subject to mark-to-market accounting, while traditional banking assets and liabilities are not.¹³⁶ Because of these asset characteristics, broker-dealers face relatively greater market risk than banks, while banks generally face relatively greater credit and liquidity risks.

These and other characteristics are reflected in the fundamentally different approaches to capital regulation under the SEC's net capital rule applicable to broker-dealers, and the minimum capital ratios applicable to banks.¹³⁷ While both regimes are intended to ensure the capital strength and solvency of the institution, the underlying rationale for the net capital rule is to promote liquidity in the interests of protecting customers and counterparties.¹³⁸

¹³⁵ It is true that the parent company of a broker-dealer or its non-broker-dealer affiliates may hold less liquid assets, but these would not typically be held in a broker-dealer. Characterizations of risks associated with the non-BHC parent companies of broker-dealers and their non-broker-dealer affiliates in the period leading up to the crisis are therefore of limited relevance to the question of broker-dealer capital regulation.

¹³⁶ See SEC, Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting at 47 (Dec. 30, 2008) (comparing the percentage of broker-dealer and bank assets that are carried at mark-to-market or similar values).

¹³⁷ Compare 17 C.F.R. §.240.15c3-1, with 12 C.F.R. apps. A, D, E and G.

¹³⁸ See SEC, Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70,214, 70,218 (Nov. 23, 2012) (the "SEC Capital and Margin Proposal") ("[The net capital rule] is a net liquid assets test that is designed to require a broker-dealer to maintain sufficient liquid assets to meet all obligations to customers and counterparties and have adequate additional resources to wind-down its business in an orderly manner without the need for a formal proceeding if it fails financially."). The SEC goes on to explain that one objective of the net capital rule and other broker-dealer financial responsibility requirements is:

[T]o protect customers from the consequences of the financial failure of a broker-dealer in terms of safeguarding customer securities and funds held by the broker-dealer. It should be noted that the Securities Investor Protection Corporation ("SIPC"), since its inception in 1971, has initiated customer protection proceedings for only 324 broker-dealers, which is less than 1% of the approximately 39,200 broker-dealers that have been members of SIPC during that timeframe. From 1971 through December 31, 2011, approximately 1% of the \$117.5 billion of cash and securities distributed for accounts of customers came from the SIPC fund rather than debtors' estates."

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The net capital requirements generally treat illiquid assets relatively harshly, regardless of their credit quality. For example, illiquid securities, illiquid collateralized debt obligations (other than very high-quality mortgage backed securities), over-the-counter derivatives, all loans (other than margin loans that comply with applicable margin regulations) and other assets such as real estate, have 100% deductions under the net capital rule, effectively requiring dollar-for-dollar capital to be held against such assets, substantially more capital than if held by a bank.¹³⁹ The effect of these deductions is to “incentivize[] broker-dealers to confine their business activities and devote capital to activities such as underwriting, market making, and advising on and facilitating customer securities transactions.”¹⁴⁰ Bank capital rules have a higher tolerance for certain types of asset risk traditionally associated with banking and recognize that it is appropriate and desirable for banks to carry illiquid assets such as loans, reflecting the fundamentally different nature of the business of banking from the business of a broker-dealer. On the other hand, the net capital rules generally require less capital for repurchase agreements involving U.S. government or agency securities than is required under the bank capital regime, reflecting greater reliance on liquid collateral in place of capital charges for such instruments. Similarly, the stress testing regimes applicable to banks and BHCs focus on their ability to maintain capital levels under stressed conditions, while stress testing expectations for broker-dealers focus on their liquidity, solvency and funding under stressed conditions.¹⁴¹

This difference in treatment of low-risk, liquid assets is a key reason why the imposition of a U.S. bank regulatory capital ratio like the leverage ratio on a U.S. broker-dealer (through the IHC) would be so punitive. The leverage ratio makes no adjustments for credit risk (counterparty or collateral) or the liquidity of a position, and therefore would substantially raise the cost of conducting low-risk activities such as participation in U.S. Treasury repo markets.¹⁴²

Id. at 70,216, n.17 (citing SIPC, Annual Report 2011).

¹³⁹ One reason that broker-dealer capital requirements are relatively more strict than bank capital requirements when it comes to illiquid assets is the differences in access to funding for banks versus broker-dealers. Banks have access to deposit funding and discount window liquidity; broker-dealers do not. Id. at 70,218.

¹⁴⁰ Id. at 70,219.

¹⁴¹ Compare 12 C.F.R. Part 252, Subparts F and H (capital stress testing for banks and BHCs with over \$10 billion in assets and for nonbank SIFIs) with FINRA Regulatory Notice 10-57 (Nov. 2010) (“FINRA expects broker-dealers to develop and maintain robust funding and liquidity risk management practices to prepare for adverse circumstances. . . . [B]roker-dealers should consider performing stress tests on a regular basis that contemplate firm-specific and market-wide events, for varying time horizons (e.g., one day, one month, one year), and varying levels of liquidity duress (e.g., moderate, high and severe). The test results can help a broker-dealer assess whether it has sufficient excess liquidity in the form of unencumbered and highly marketable securities to meet possible funding shortfalls without the need to sell less liquid assets at fire-sale prices or depend on additional funding from credit-sensitive markets.”). Under the SEC Capital and Margin Proposal, alternative net capital (“ANC”) broker-dealers and nonbank security based swaps dealers (“SBSDs”) approved to use internal models for calculating net capital requirements would be required to take additional steps to manage funding liquidity risk, including by performing monthly (or more frequent) liquidity stress tests and maintaining liquidity reserves and contingency funding plans based on the results of those stress tests. See 77 Fed. Reg. 70,214, 70,252.

¹⁴² Some have estimated that as much as \$330 billion in capacity, representing over 10% of the total size of the repo market, could be withdrawn under the FRB’s proposal. See Oliver Wyman Study at 24 – 25.

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The Board does not explain in the Proposal why it believes a balance sheet leverage ratio should be applied to broker-dealers owned by FBOs.¹⁴³

In short, the fundamental differences in the approach and context of the broker-dealer and bank capital requirements make a meaningful comparison of the two regimes difficult, if not impossible. Determining whether the broker-dealer regulatory framework allows broker-dealers to operate in a manner that presents greater risks of insolvency than banking entities would involve not only the “apples-to-oranges” comparison of the two capital regimes discussed above, but also a detailed analysis of the differences in their business and asset mix, as well as the other regulatory and market factors that affect their risk. Even if possible, a comparison of the relative pros and cons of the two different regulatory frameworks offers very little insight on the ultimate question of how to implement Section 165 for FBOs. That question should instead depend more significantly on the actual risks presented by the broker-dealer affiliates of the small handful of FBOs that might reasonably present risks to U.S. financial stability on a scale within the contemplation of Section 165. Making a blanket decision to apply bank capital treatment to the U.S. broker-dealer affiliates of FBOs simply by nature of their affiliation with an FBO ignores the fundamental differences in the business models and risks presented by each and the practical reality that there are only a few FBOs with systemically important broker-dealer operations in the United States.¹⁴⁴

The accepted separate domains of bank and broker-dealer capital regulation led Congress to impose restrictions on the Board’s consolidated supervisory authority over BHCs with respect to a BHC’s functionally regulated subsidiaries in the GLBA.¹⁴⁵ Although Dodd-Frank repealed many of these restrictions,¹⁴⁶ it left in place Section 5(c)(3) of the BHC Act, which prohibits the Board from imposing capital standards on broker-dealers and other functionally regulated subsidiaries of BHCs, so long as (in the case of broker-dealers) they are in compliance with the applicable capital requirements of the SEC.¹⁴⁷ The fact that Congress repealed some restrictions on the Board’s supervisory authority over functionally regulated subsidiaries in the Dodd-Frank Act, but specifically retained Section 5(c)(3), clearly demonstrates that Congress meant for the Section 5(c)(3) limitation to continue as a limitation on the Board’s supervisory authority.

As set forth in our White Paper and discussed elsewhere in this letter, we believe that Section 165 provides the Board with the authority to address specific risks to U.S. financial

¹⁴³ We recognize, of course, that the Board imposes regulatory capital requirements on U.S. BHCs that own broker-dealers, including in some cases U.S. BHCs whose broker-dealers comprise a significant portion of their consolidated U.S. operations. However, the policy question for the Board in this aspect of the Proposal is the justification for super-imposing a leverage ratio requirement on a U.S. broker-dealer subsidiary of an FBO that is already subject to consolidated regulatory capital regulation in its home country (including the Basel III leverage ratio once implemented).

¹⁴⁴ While this letter is focused on the Proposal as it applies to FBOs, these same concerns would apply equally to foreign nonbank financial companies.

¹⁴⁵ See GLBA, Pub. L. No. 106-102, §§ 111, 113, 113 Stat. 1338, 1362 – 626, 1368 – 69, (1999), amending 12 U.S.C. § 1844(c) and enacting 12 U.S.C. § 1848a.

¹⁴⁶ See Dodd-Frank § 604(c).

¹⁴⁷ See 12 U.S.C. § 1844(c)(3).

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stability presented by FBOs, including their functionally regulated subsidiaries. However, Section 165 cannot be read to give the Board plenary authority to create broadly applicable capital standards that are clearly targeted towards an entire class of broker-dealers, *i.e.*, those owned by foreign banks. The Proposal does not address the Board’s legal authority to use a categorical IHC requirement to impose bank capital standards on a class of broker-dealers, especially where the IHC concept is explicitly authorized elsewhere in the Dodd-Frank Act but not in the context of Section 165.¹⁴⁸ Given that the IHC requirement is targeted towards imposing capital requirements on the broker-dealer affiliates of FBOs; that Dodd-Frank did not repeal Section 5(c)(3) of the BHC Act and did not expressly give the Board authority to require FBOs to form IHCs (other than in certain circumstances not related to Section 165); and given the lack of any specific finding that broker-dealer affiliates of certain FBOs present a systemic risk to the United States, it appears that the Board would not have legal authority to move forward with the IHC requirement as currently designed. The fact that the Proposal’s capital requirements would apply to the IHC on a consolidated basis as opposed to an FBO’s actual U.S. broker-dealer subsidiaries does not change the analysis—especially in the case of FBOs whose IHCs would predominantly consist of their U.S. broker-dealer operations and other functionally regulated subsidiaries, and even more acutely for FBOs that do not control a U.S. bank or BHC subsidiary—since it is well established that an agency cannot “do indirectly what it cannot do directly.”¹⁴⁹

Rather than take unilateral action against a class of broker-dealers based on questionable legal authority, the Board should seek to resolve its concerns regarding broker-dealer capital in coordination and consultation with FINRA and the SEC. Indeed, reform of broker-dealer liquidity and leverage continues to develop in the wake of the recent financial crisis. In November 2012, shortly before the Board released the Proposal, the SEC proposed revisions to its net capital rule to strengthen the net capital and liquidity requirements for large broker-dealers.¹⁵⁰ FINRA has also taken steps to strengthen its oversight of broker-dealer

¹⁴⁸ See, *e.g.*, Dodd-Frank Act §§ 167 and 626 (providing the Board with discretion to require the creation of IHCs for systemically important nonbank financial companies and savings and loan holding companies, respectively).

¹⁴⁹ *Civil Aeronautics Board v. Delta Air Lines*, 367 U.S. 316, 328 (1961). To the extent that the Board would justify its legal authority to overcome Section 5(c)(3) on the basis of Section 165 being a later enacted statute, and a provision that is not codified in the BHC Act, we would respectfully suggest that imposition of an IHC requirement on any broker-dealer or category of broker-dealers would—at a minimum—require significantly more findings and ties to actual threats to U.S. financial stability than are reflected in the Proposal. Indeed, an important advantage of the SI-FBO Framework that we suggest in Part I.B is that by grounding the measures in findings of unaddressed systemic risk, and giving FBOs the discretion to propose a U.S. systemic risk remediation plan to address those risks (which could include reducing leverage in a U.S. broker-dealer, forming and capitalizing an IHC, etc.), the legal authority concerns presented by Section 5(c)(3) are mitigated.

¹⁵⁰ See 77 Fed. Reg. 70,214, 70,227 – 28 (Nov. 23, 2012) (“[T]he proposed enhancements would include increasing the minimum tentative net capital and minimum net capital requirements; increasing the ‘early warning’ notice threshold; narrowing the types of unsecured receivables for which ANC broker-dealers may take a credit risk charge in lieu of a 100% deduction; and requiring ANC broker-dealers to comply with a new liquidity requirement.”). The SEC’s proposals to strengthen capital and liquidity requirements for ANC broker-dealers were “made in response to issues that arose during the 2008 financial crisis, recognizing the large size of these firms, and the scale of their custodial responsibilities.” See *id.* ANC broker-dealers are broker-dealers that have been approved by the SEC to use internal value-at-risk models

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liquidity and leverage, and issued detailed guidance in 2010 regarding funding and liquidity risk management practices for broker-dealers.¹⁵¹ This guidance provides best practices for robust risk monitoring and reporting, stress testing, contingency funding planning and other measures intended to address liquidity risks. In addition, FINRA is closely monitoring broker-dealer leverage and considering implementing leverage limits.¹⁵² Further, the CFTC imposes capital requirements for broker-dealers engaged in activities regulated by the CFTC. The CFTC has substantially increased several of these requirements following the financial crisis.¹⁵³ In addition, the CFTC and SEC have proposed rules to establish capital and margin requirements for swap dealers and security-based swap dealers, respectively.¹⁵⁴

To the extent the Board concludes that these developments are insufficient to address systemic risks posed by broker-dealers to the U.S. financial system and cannot reach agreement with the SEC on appropriate measures to address U.S. financial stability concerns associated with broker-dealer activities, it should raise its concerns with the FSOC, which was created precisely for the purpose of ensuring effective coordination among federal financial regulators in addressing risks to U.S. financial stability.¹⁵⁵ The IHC Requirement, proposed unilaterally and apparently without significant attempts at cooperative development with the SEC or other functional prudential supervisors, would be a counterproductive measure that further complicates the ability of regulators to cooperate to address systemic risks to the United States.

Lastly, we would respectfully suggest that the implications for FBO-controlled broker-dealers in the United States should be a specific area of study and analysis of the relevant costs and benefits of the IHC requirement. This analysis should include an assessment of the likely impact of creating incentives for such U.S. broker-dealers to reduce the scale of their repo

to determine market risk charges for proprietary securities and derivatives positions and to take a credit risk charge in lieu of a 100% charge for unsecured receivables related to OTC derivatives transactions. See id. at 70,216.

¹⁵¹ FINRA, Regulatory Notice 10-57 (Nov. 2010).

¹⁵² FINRA, Regulatory Notice 10-44 (Sept. 2010). Under Notice 10-44, a firm with a leverage ratio of greater than 20 to 1, after excluding U.S. Treasury and U.S. government agency inventory, must report this to FINRA and provide additional detail regarding its balance sheet. FINRA and the firm then recalculate the ratio excluding other government-guaranteed assets. FINRA is also considering a rulemaking regarding leverage limits.

¹⁵³ See 17 C.F.R. § 1.17 (adjusted net capital requirements applicable to introducing brokers and futures commission merchants). This requirement, which sharply increased the required level of capital for certain noncustomer positions held by futures commission merchants, went into effect in early 2010. See 74 Fed. Reg. 69,279 (Dec. 31, 2009).

¹⁵⁴ See 77 Fed. Reg. 70,214 (Nov. 23, 2012) (SEC proposal of capital and margin rules for security-based swap dealers and major security-based swap participants); 76 Fed. Reg. 27,802 (May 12, 2011) (CFTC proposal of capital and margin requirements for swap dealers and major swap participants).

¹⁵⁵ See, e.g., Dodd-Frank § 112(a)(2)(E) (the FSOC's duties include to "facilitate information sharing and coordination among [its] member agencies"). See also Dodd-Frank § 119 (charging the FSOC with the duty to "seek to resolve a dispute among 2 or more member agencies" regarding jurisdictional issues).

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activities involving U.S. government, agency and government-sponsored entity securities, including any potential impact on the Board's monetary policy tools.¹⁵⁶

B. The SI-FBO Framework: A Proposed Alternative Approach to the Section 165 Standards

In our White Paper, we set forth what we believe to be a more appropriate alternative approach to applying the Section 165 Standards to SI-FBOs, an approach we named the "SI-FBO Framework". Under this alternative, tailored approach, the Board would apply heightened scrutiny to each FBO potentially subject to Section 165—including evaluation of the FBO's home country regulatory and supervisory regime—and determine the appropriate tailored application of the Section 165 Standards to any FBO found to be a systemically important SI-FBO. The Board's evaluation of each institution and subsequent determination of whether any Section 165 Standards should apply to the institution would occur under a framework set out in Board regulations transparently developed through a public rulemaking process. The SI-FBO Framework would allow the full consideration of all factors relevant to the relationship between the U.S. operations of a SI-FBO and U.S. financial stability, permit adjustments for developments in the SI-FBO's home country supervisory requirements and facilitate decisive and effective actions to address actual risks presented by SI-FBOs. At the same time, it would spare FBOs that are not systemically important from burdensome and counterproductive additional regulation.

We have continued to develop our proposed SI-FBO Framework, including in response to, and taking into account, the concepts and rationales articulated in the Proposal. We have also attempted to refine our proposal to reflect certain limitations on the Board's legal authority vis-à-vis functionally regulated subsidiaries, which present significant obstacles to the categorical IHC requirement as reflected in the Proposal (see Part I.A.9.f above).

1. *Heightened Scrutiny of SI-FBO Operations and Home Country Regulation*

The SI-FBO Framework would require supervisory analysis of the need for additional U.S.-based capital, liquidity or other prudential standards on an institution-by-institution basis. The purpose of this analysis would be to determine whether targeted Section 165 Standards are necessary to prevent or mitigate risks to the financial stability of the United States from a SI-FBO's U.S. operations. The criteria for this analysis should be flexible and inclusive to capture the full range of considerations relevant to a SI-FBO's U.S. operations, including its home country regulatory context. This analysis should include consideration of:

- The scope, nature, scale and risk profile of U.S. activities of the SI-FBO (both its banking and nonbanking operations);
- The degree and nature of interconnections between the organization's banking and nonbanking activities in the United States, and their interconnection with activities outside the United States;

¹⁵⁶ See generally Oliver Wyman Study.

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- The extent and character of the U.S. regulation of the SI-FBO’s functionally regulated entities in the United States, including IDIs, branch and agency offices, broker-dealers, swaps dealers and insurance companies;
- The financial strength of the top-tier parent of the SI-FBO (and, if relevant, of other affiliates);
- Information available through the SI-FBO’s recovery and resolution planning process, including its formal U.S. submissions, submissions in other jurisdictions available to the Board, and information available to the Board through recovery and resolution coordination with other regulators (e.g., through the crisis management group for the firm or other international cooperation arrangements);
- Other information available to the Board from home country (or other host country) supervisors and the SI-FBO itself; and
- The home country supervisory and regulatory context of the SI-FBO.

The Board’s heightened evaluation of a SI-FBO’s home country supervisory and regulatory context should likewise be conducted broadly, and include consideration of existing and planned elements of the home country supervisory and legal framework relevant to the operations, stability and potential recovery or resolution of the SI-FBO. Home country implementation of the Basel Capital Framework (including Basel II and Basel III) and Basel III liquidity framework would be central elements, as would any “G-SIB” or other capital “surcharge”. We believe that the Board should also consider additional factors less directly related to capital and liquidity but also relevant to U.S. financial stability. For example, the insolvency regime and any special resolution regime applicable to the SI-FBO will likely be relevant, as will the hierarchy of creditor preferences and its impact on the availability of funds to satisfy depositors and other creditors of the SI-FBO’s U.S. operations. If the result of the Board’s analysis is a determination that the consolidated capital, liquidity and other prudential standards applicable to the SI-FBO are comparable to the Section 165 Standards, and that—after adjusting for the effects of the applicable insolvency regime and other relevant aspects of the home country regulatory and legal framework—the U.S. operations of the SI-FBO are adequately covered by these requirements, the Board should defer to the SI-FBO’s consolidated home country supervision and refrain from imposing additional U.S.-specific regulatory requirements.

The case-by-case analysis of SI-FBOs and their home country supervisory context under the SI-FBO Framework likely will require SI-FBOs to provide the Board with information of greater detail and broader scope than the Board’s current supervisory approaches require or that would be needed with respect to FBOs that are not SI-FBOs. The IIB recognizes that the SI-FBO Framework could result in more intrusive inquiries by the Board regarding the home country operations and supervision of SI-FBOs as well as applicable legal regimes. While we would expect that international cooperation and coordination among the home and host country supervisors of SI-FBOs will be an efficient source of high-quality information in these areas, we understand that additional information burdens are a likely implication of the heightened degree of supervision contemplated by the SI-FBO Framework.

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The Board’s long-standing supervisory and regulatory authority over FBOs, expanded by Dodd-Frank for purposes of addressing risk to U.S. financial stability, is more than sufficient to meet the information requirements of the SI-FBO Framework. The Board has historically supervised the combined U.S. operations of FBOs in close coordination with other state and federal supervisors under the authority granted to it by the International Banking Act and the Foreign Bank Supervision Enhancement Act.¹⁵⁷ Although the GLBA imposed restraints on the ability of the Board directly to examine certain U.S. entities that are functionally regulated by another U.S. agency, Dodd-Frank specifically repealed these restrictions.¹⁵⁸ Dodd-Frank also provides the Board with additional authorities to address systemic risks posed by non-U.S. SIFIs, including Section 165’s clear authority to act to address risks to U.S. financial stability posed by FBOs.¹⁵⁹

2. *Tailored Measures to Address Risks to U.S. Financial Stability*

The SI-FBO Framework should provide for targeted application of the Section 165 Standards to a SI-FBO’s specific U.S. activities or operations that present potential systemic risks to the United States, taking into account any Board assessment of home country supervision and regulation, its coverage of U.S. operations, and the adequacy of the functional regulation of U.S. entities. Following a determination by the Board that an FBO presents systemic risks to U.S. financial stability that are not addressed by other means, the Board would require the FBO to design a systemic risk remediation plan that would include targeted measures to mitigate the identified risks. Examples of such targeted measures that an FBO could choose to propose would include:

- Commitments to limit “due from” positions in the SI-FBO’s U.S. branch network;

¹⁵⁷ See 12 U.S.C. §§ 3102, 3105. See also Board SR Letter 08-9, Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008); Board SR Letter 00-14, Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (Oct. 23, 2000) (“SOSA rankings reflect an assessment of a foreign bank’s ability to provide support for its U.S. operations. The ROCA system represents a rating of the risk management, operational controls, compliance and asset quality of an FBO’s U.S. activities.”).

¹⁵⁸ See GLBA §§ 111, 113 (amending 12 U.S.C. § 1844(c) and enacting 12 U.S.C. § 1848a); Dodd-Frank § 604 (reversing GLBA restrictions on Board supervision of functionally regulated subsidiaries).

¹⁵⁹ In addition, Section 121 of Dodd-Frank authorizes the Board to condition or require the termination of specific activities of a SIFI if it determines that the institution poses a grave threat to the financial stability of the United States. The Board also has the authority to order a branch or agency office of an FBO to terminate its activities if the FBO presents a risk to the stability of the U.S. financial system and its home jurisdiction “has not adopted, or made demonstrable progress toward adopting, an appropriate system of financial regulation to mitigate such risk.” Dodd-Frank § 173(b)(3). We recognize that these provisions of Dodd-Frank are extraordinary remedies that are intended to be rarely—if ever—invoked. However, they remain important backstops to the Board’s implementation of its Section 165 authority and therefore are relevant to the consideration of what supervisory standards are necessary to regulate SI-FBOs. In addition, they demonstrate Congress’ clear expectation that other jurisdictions would address the risks posed by SIFIs headquartered outside the United States. They also demonstrate Congress’ intent that the Board evaluate heightened home country supervision of SI-FBOs and, by implication, rely on home country supervision where robust and effective.

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- Agreement to heightened asset maintenance requirements for the SI-FBO's U.S. branch network;
- Agreement to supplemental capital requirements to mitigate risks arising from activities in a nonbank subsidiary; and
- Agreement to supplemental capital or liquidity requirements for specific U.S. activities or classes of transactions conducted by a SI-FBO determined to be relevant to U.S. financial stability.

By targeting specific activities or operations with tailored measures designed to address their particular systemic risks, the FBO and the Board can ensure that U.S. systemic risk concerns are fully addressed and that supervisory resources are not diluted through application to U.S. activities and operations that do not pose systemic risks. This targeting of heightened standards would also avoid the unnecessary duplication of existing home and host country regulations already applicable to a SI-FBO's U.S. operations when home country standards and existing U.S. regulation adequately address potential risks to the United States.

3. *Implementing the SI-FBO Framework in a Manner Consistent with the Board's Existing Supervisory Framework for FBOs and Its Enhanced Supervisory Authority under Dodd-Frank*

The Board's Section 165 authority is best viewed—and will be most effective—as an extension and enhancement of the Board's existing framework for supervision of the U.S. operations of FBOs and evaluation of their global strength and home country supervision. By operating through existing structures, the Board can leverage its current supervision of and experience with FBO operations in the United States to directly target the greatest sources of systemic risk.

For example, assume that an FBO operating in the United States through both a U.S. branch office and a U.S. bank subsidiary has a large “due from” position in its U.S. branch (*i.e.*, the U.S. branch is funding the non-U.S. offices of the foreign bank) that the Board determines is relevant to U.S. financial stability. If home country capital and liquidity requirements applicable to this FBO do not sufficiently address the Board's concerns, the Board could take direct remedial action by identifying this deficiency to the FBO. The FBO could in turn commit in writing to limit the branch's due-from position, or agree to heightened liquidity requirements for the branch, rather than through capital and liquidity requirements applicable to its U.S. operations more generally. The cost and impact of applying categorical requirements would be much larger than imposing measures targeted to the risk identified by the Board. Many of the requirements in the Proposal, and in particular the IHC requirement, would be completely irrelevant to the specific source of systemic risk in this example. Adopting a tailored approach would permit the FBO's U.S. bank subsidiary and other U.S. operations to be left undisturbed so long as they are operating in a safe and sound manner.

In this example, the Board's initial posture towards the SI-FBO would be substantially the same as it is today. The Board's recent enhancements to its supervision practices, combined with the increased supervisory authority provided by Dodd-Frank, would

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provide the high-quality information necessary to monitor and evaluate SI-FBOs individually and tailor to each firm any measures necessary to address systemic risk.¹⁶⁰ Section 165 would provide the Board with clear authority to require direct remedial actions tailored to address any potential risks to U.S. financial stability presented by a SI-FBO in a more effective and less burdensome manner than the Proposal's one-size-fits-all approach.

Such an approach would allow the Board to address directly and decisively any systemic risks posed by the U.S. operations of SI-FBOs, and focus limited supervisory resources on actual sources of real risk to U.S. financial stability. This approach would also allow the Board to consider on an institution-specific basis the impact of the continuing evolution of international and home country efforts to strengthen oversight of SIFIs.

In sharp contrast, the IHC requirement and other measures in the Proposal that would categorically apply Section 165 Standards without due consideration of the availability and support of capital and liquidity to these operations from non-U.S. parents and affiliates would have significant implications for U.S. financial stability and significant unintended macroeconomic effects. Such measures would discourage FBO activity in the United States, reducing volume, competition and diversity in U.S. financial markets, thereby increasing concentration and detracting from the stability of the U.S. financial system. Reduction of FBO participation in U.S. markets, particularly the commercial credit markets and repo market, could also hamper macroeconomic growth.¹⁶¹ We therefore urge the Board to reconsider the IHC requirement and other categorical aspects of its proposal, and to repropose a new framework consistent with the SI-FBO Framework described herein that relies on vigorous home country consolidated supervision and on targeted interventions to address specific risks that might be presented by particular SI-FBOs.

4. *Trade-Offs Associated with the SI-FBO Framework*

We recognize that the SI-FBO Framework would involve certain trade-offs both from the perspective of the Board's supervisory objectives and from the perspective of SI-FBOs that would need to comply with the SI-FBO Framework. We do not believe there is a perfect solution to implementing Section 165 for FBOs, and we have attempted in the development of the SI-FBO Framework and the formulation of our comments in this letter to take into account some of the potential downsides of the approach we are suggesting.

For example, the SI-FBO Framework would require the Board to make judgments about the strength of the FBO parent in the context of its home country supervisory and regulatory regime and its implications for U.S. financial stability. The Board may prefer not to be in a position where it might be required to conclude that the strength of a FBO parent and likelihood of support for its U.S. operations were deficient such that imposition of an IHC requirement or other prudential measure would be necessary. However, in the case of

¹⁶⁰ See Dahlgren Remarks (describing increased focus of examiners on understanding the overall activities of and risks to each firm); Board SR Letter 12-17 (Dec. 17, 2012) (announcing the establishment of the Large Institution Supervision Coordinating Committee to monitor the risks presented by the largest, most complex U.S. and foreign financial organizations supervised by the Board).

¹⁶¹ See Oliver Wyman Study at 19 – 25.

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Section 165, Congress specifically instructed the Board to consider “the extent to which the foreign financial company is subject on a consolidated basis to [comparable] home country standards” (emphasis added).¹⁶² The Board should not abdicate this responsibility through blanket judgments covering multiple, diverse home country regulatory regimes.

The Board has made comparable assessments under pre-Dodd-Frank laws, regulations and policies and is charged under Dodd-Frank with making comparable judgments in other contexts. For example, the Board determines whether a bank is subject to comprehensive consolidated supervision under the BHC Act and the IBA, as amended by the Foreign Bank Supervision Enhancements Act of 1991. The Board also issues bank-specific SOSA ratings, which directly implicate not just the strength of the parent FBO but also its home country supervisory and regulatory regime. In addition, under Dodd-Frank, the Board is required to consider in the context of applications for approval of certain acquisitions whether the proposed acquisition “would result in greater or more concentrated risks to global or United States financial stability or the United States economy,”¹⁶³ and, in the context of FBO applications for approval to establish a U.S. branch “for a foreign bank that presents a risk to the stability of [the] United States financial system, whether the home country of the foreign bank has adopted, or is making demonstrable progress toward adopting, an appropriate system of financial regulation for the financial system of such home country to mitigate such risk.”¹⁶⁴

As an added benefit, the types of assessments that the Board would make under the SI-FBO Framework would give home country supervisors reasons to consider the implications of the measures that they elect to adopt (or not adopt), with incentives to adopt measures that mitigate financial stability risks globally and to the United States. The Proposal, in contrast, to some degree undoes those incentives because it would eliminate any benefits of strong home country supervisory measures for the U.S. operations of FBOs.¹⁶⁵ This would also appear to contravene the Board’s mandate in Section 175 of Dodd-Frank that it and the Treasury Secretary “consult with their foreign counterparts and through appropriate multilateral organizations to encourage comprehensive and robust prudential supervision and regulation for all highly leveraged and interconnected financial companies.”¹⁶⁶

We have also considered the fact that case-specific findings and systemic risk remedies could introduce an element of stigma if counterparties or other market participants come to perceive that a requirement imposed by the Board on the U.S. operations of an FBO implies specific doubts about the strength of the FBO parent or likelihood of parent support for the U.S. operations of the FBO. In our view, however, the risks of meaningful stigma in this regard are small. We would anticipate that most systemic risk remediation requirements would remain confidential supervisory information, just as SOSA ratings and their implications are

¹⁶² Dodd-Frank § 165(b)(2)(B).

¹⁶³ Id. § 163(b)(4).

¹⁶⁴ Id. § 173(a).

¹⁶⁵ Of course, home country supervisors have other powerful incentives to implement strong home country measures for SI-FBOs, but the Proposal’s approach would remove incentives to address U.S. financial stability concerns in those measures.

¹⁶⁶ Id. § 175(c).

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typically confidential. And the effects of any such requirements (even structural changes) may not rise to the level of required public disclosures. In addition, the introduction of such measures may in some cases be viewed favorably by counterparties to the U.S. operations.

We also appreciate that a more finely tailored approach to the application of heightened prudential standards will create the potential for disparate treatment among FBOs. Some FBOs may be subjected to stricter standards than others, and this would result from a more discretionary and less predictable process. Some degree of differentiation is already inherent in the Proposal and would be part of any tailored implementation of Section 165. And in one sense a more tailored approach avoids a degree of arbitrariness that arises from categorical approaches, which necessarily create “cliff effects” at the relevant thresholds for triggering heightened prudential standards. On balance we are comfortable with this implication of our suggested approach, especially as individual FBOs and their home country supervisors would have the opportunity to discuss the development of appropriate systemic risk remediation measures with the Board’s supervisory staff. We would also observe that similar implications arise from many aspects of the Board’s supervisory process, including the implications of supervisory ratings such as restrictions on activities and investments that arise for a financial holding company that is required to enter into a “4(m) agreement.”

Our proposal would also necessarily involve evolving judgments by supervisory staff of the Board and the Federal Reserve Banks, which gives rise to logical questions about procyclical effects of measures imposed at the time of stress and the human fallibility of bank supervisors. Indeed, we read in the Proposal not just a concern about procyclical effects but a distinct preference for prophylactic *ex ante* approaches designed to reduce reliance on human judgments in the bank supervisory process. While procyclical effects and human fallibility are both understandable concerns, in our view there are two important factors that support our approach. First, the erection of *ex ante* standards could also have procyclical effects by automatically ratcheting up pressure and reducing flexibility at the time stress emerges (including in particular the early remediation framework). An approach involving supervisory judgment and discretion can take potential procyclical effects into account. Second, in the realm of supervision of SI-FBOs, and taking into account newly developed levels of engagement by on-site supervisors, we believe it is fair to conclude that the risk of bank supervisors missing emerging risk trends is significantly reduced.¹⁶⁷

In short, while we recognize the various trade-offs discussed above, we have concluded that the advantages of our proposed approach—more meaningful and effective tailoring to address systemic risk, greater consistency with Section 165, mitigated risks of macroeconomic harms, etc.—greatly outweigh these potential downsides.

C. Specific Issues Regarding the Proposed IHC Requirement

Although we strongly urge the Board to reconsider the IHC concept as a categorical requirement, to the extent the Board retains an IHC requirement in its final rule implementing Section 165 there are a number of specific features of the IHC requirement that should, in our view, be modified. We emphasize that these modifications are, in our view,

¹⁶⁷ See, e.g., Dahlgren Remarks; Board SR Letter 12-17.

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“second-best” changes that could mitigate some of the adverse unintended consequences of the IHC requirement but would fail to address its fundamental flaws.¹⁶⁸

1. *At a Minimum, the Scope of the IHC Requirement Should Be Adjusted to Align More Closely with the Policy Objective of Protecting U.S. Financial Stability*

As discussed in Part I.A, the flaws and unintended consequences associated with a categorical IHC requirement are exacerbated by the overbreadth of its proposed application. Consequently, we would urge the Board, should it retain a requirement to form an IHC as a separate legal entity, to limit the IHC requirement’s impact on FBOs that are not systemically important by (1) raising the threshold that triggers the IHC requirement; and (2) providing a mechanism for FBOs above the threshold to obtain a waiver of the requirement.

We would respectfully suggest that an initial threshold for presumptive application of the IHC requirement of \$50 billion or greater in U.S. non-branch assets would more closely align the IHC requirement with its stated purpose—protecting U.S. financial stability in furtherance of Section 165. A \$50 billion threshold would also more appropriately parallel the threshold for applying enhanced prudential standards to U.S. BHCs.¹⁶⁹

In our view, it should be clear without further study that an FBO whose IHC-eligible U.S. operations represent less than \$50 billion on a consolidated basis does not threaten U.S. financial stability. That is, the FBO and/or its U.S. subsidiaries could fail without disrupting U.S. financial stability. Indeed, we could argue that an even higher threshold should apply in light of the fact that the market and customer perception issues related to the failure or stress of a financial institution are mitigated for a foreign-headquartered institution that is not a main street “name brand” institution with a national presence.¹⁷⁰ In addition, we also recognize that any assets-based threshold for application of an IHC requirement will be inherently arbitrary to some degree, create cliff effects, etc., but we would respectfully submit that a \$50 billion IHC-eligible assets threshold is both more aligned with the Board’s policy objective and more consistent with the threshold that applies to a U.S. BHC.

However, because even a \$50 billion threshold will be too low in some cases, FBOs above the IHC threshold should be permitted to demonstrate that an IHC is not required due to (i) the size, character and (lack of) systemic importance of an FBO’s U.S. operations;

¹⁶⁸ Even ignoring the basic policy issues raised above, the tax costs many FBOs would incur if required to restructure under the IHC requirement could be fully avoided only by abandoning the requirement altogether and adopting either a fully tailored approach to the Section 165 Standards along the lines of the SI-FBO Framework or, at a minimum, the “virtual IHC” approach described in Part I.F below.

¹⁶⁹ The precise logic of the \$10 billion non-branch assets threshold for the IHC requirement in the Proposal is not exactly clear. The preamble to the Proposal indicates that the Board “has chosen the \$10 billion threshold because it is aligned with the \$10 billion threshold established by the Dodd-Frank Act for stress test and risk management requirements.” 77 Fed. Reg. at 76,638. However, the Board in the Proposal applies the \$10 billion thresholds for both of those requirements based on the global assets, not the U.S. non-branch assets, of the FBO. See Proposal §§ 252.250 and 252.264.

¹⁷⁰ We recognize that some FBOs operate U.S. “name brand” retail banking operations that would not fit this description.

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(ii) the resolvability of the FBO's U.S. operations under traditional insolvency laws; (iii) the extent to which an FBO's home country supervision (and existing U.S. regulation) addresses U.S. financial stability concerns; (iv) the operational or legal obstacles to formation of an IHC structure (including excessive restructuring and tax costs); (v) whether the FBO controls an IDI; and (vi) other relevant factors, including the nature of the FBO's assets. Especially in view of the fact that the IHC requirement is something the Board created on its own initiative in the Proposal (i.e., is not required under Section 165), the Board should retain broad discretion to entertain exemptions from the requirement in appropriate circumstances.

2. *FBOs Subject to the IHC Requirement Should Have Significant Flexibility to Structure Their U.S. Operations*

We support the Proposal's acknowledgement that the Board would retain flexibility to modify the IHC requirement to accommodate multiple IHCs or "alternative organizational structure[s]".¹⁷¹ Given the organizational and strategic diversity of FBOs, it is critical that the Board retain flexibility to modify the requirements when the circumstances weigh in favor of such changes, so long as the Board's financial stability concerns under Section 165 are adequately addressed. Set forth below are a number of circumstances where the IHC requirements should be adjusted to avoid unnecessary burdens or inappropriate results.

- (a) As a Default Rule, Only U.S. Subsidiaries that Would Be Required to Be Consolidated with the IHC under U.S. GAAP or Other Applicable Accounting Standards Should Be Required to Be Held under an IHC

The default rule for defining the universe of an FBO's U.S. subsidiaries that would need to be held under the IHC should be U.S. legal entities that are subsidiaries as defined in the Proposal and would be required to be consolidated with the IHC under U.S. generally accepted accounting principles ("GAAP") (or another applicable accounting standard, such as IFRS) if the relevant ownership interest were held by the IHC.¹⁷² By including only consolidated subsidiaries, the IHC would own all of the subsidiaries whose assets and liabilities would normally be consolidated with the IHC, including for purposes of compliance with U.S. regulatory capital requirements. The FBO should not, in contrast, be required to transfer minority investments, joint ventures, etc., to the extent that the relevant entity would not be consolidated with the IHC. Similarly, CLOs and other asset-backed securities ("ABS") issuers should generally not be considered part of an IHC if they are not consolidated for purposes of GAAP.¹⁷³

Allowing the FBO to continue to own these interests directly or through a separate chain of ownership outside the IHC structure would be consistent with the Board's objective of protecting U.S. financial stability because the relevant accounting, risk and

¹⁷¹ Proposal § 252.202.

¹⁷² See also our proposed modifications to the Proposal's definition of "subsidiary" in Part I.C.2.c below.

¹⁷³ Even if an FBO is required to consolidate an ABS issuer under GAAP, it should still be permitted to exclude the issuer from the IHC if it lacks true, practical control over the issuer. See Part I.C.2.b below.

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regulatory capital consequences for the FBO associated with such interests would be borne by the FBO outside the United States. In our view, there should be no reason to force such risk and consequences into the IHC structure where they would otherwise reside with the FBO parent. At a minimum, existing investments in companies that are not financially consolidated with the FBO should be “grandfathered” so that FBOs are not required to relocate them into their IHCs.

Similarly, if an FBO owns a majority interest in a U.S. subsidiary indirectly and a minority interest directly, it should be sufficient if the FBO transfers the majority interest to the IHC, resulting in consolidation with the IHC, and retains the minority interest as a direct ownership interest outside the IHC.¹⁷⁴

(b) The Board Should Grant Exemptions by Rule or Order for Subsidiaries that an FBO Does Not Practically Control

The Board should not require FBOs to move under their IHCs: (i) joint ventures, minority interests and other “subsidiaries” over which an FBO has “control” under the BHC Act but lacks actual, practical control; and (ii) interests in such entities where the FBO is unable to force a transfer of its interest in the entity into the IHC, or where transfer into the IHC or consolidation with the IHC would be inappropriate.¹⁷⁵ Recognizing that a categorical exclusion of such entities would require the development of a new regulatory standard for “BHC Act control but not practical control,” we would instead suggest as an administrative matter that the Board establish a procedure for an FBO to demonstrate that a BHC Act subsidiary is not practically controlled by the FBO or could not be unilaterally transferred to the IHC (or otherwise could not be transferred without undue burden associated with the lack of practical control).

(c) The Board Should Modify the Definition of “Subsidiary” for Purposes of the IHC Requirement to Make It Clearer in Application

If the BHC Act definition of “subsidiary” is retained to define the perimeter of the IHC requirement in at least some cases, the Board should apply a simplified definition to avoid the fact-specific judgments that are required under the BHC Act’s “controlling influence” test. Specifically, the Board should limit “subsidiaries” for this purpose to companies in which an FBO directly or indirectly owns or controls 25% or more of a class of voting securities. This approach would be consistent with the modified definition of “subsidiary” in the Board’s

¹⁷⁴ It is not uncommon for an FBO parent to own—either directly or through a separate branch or chain of ownership—a minority interest in a U.S. broker-dealer subsidiary. As noted in Part II below, such split ownership structures also raise questions regarding how the IHC’s regulatory capital would be calculated with respect to its majority ownership of the relevant subsidiary.

¹⁷⁵ In addition to issues involving minority investments and joint ventures held directly by an FBO in U.S. nonbank financial companies, the Federal Reserve should also be accommodative of “controlling” minority investments in non-U.S. entities that themselves have U.S. financial subsidiaries.

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regulations implementing another, related provision of Section 165—the resolution plan requirement.¹⁷⁶

- (d) FBOs Should Be Permitted to Establish One or More IHCs to Remain Consistent with Their Existing Organizational and Management Structures

The IIB supports the Board’s affirmation in the Proposal that FBOs with a tiered FBO structure could justify structural and other accommodations under the IHC requirement.¹⁷⁷ We expect that it will be important to permit FBOs in a classic tiered structure (*i.e.*, one FBO that has BHC Act “control” over another FBO) to form multiple IHCs—one for each FBO in the corporate group. Such tiered FBOs often include foreign banks in separate jurisdictions with independent management, strategies, etc., and the need for flexibility becomes especially acute when one foreign bank holds a minority interest in another FBO that the Board determines constitutes BHC Act “control” but does not involve practical control.

However, we would urge the Board to apply this principle more broadly in practice as it reviews requests for approval of alternative organizational structures. For example, in some cases more than one foreign bank with U.S. banking operations may be owned by a holding company that itself is treated as an FBO. In that case, a similarly compelling case for multiple IHCs—one for each FBO—would be present. Similarly, in some cases a foreign bank with U.S. banking operations may be owned by a holding company that controls a separate insurance operation through a separate chain of ownership (*i.e.*, not under the foreign bank). The bank and insurance operations may be managed separately, and there may be legal or supervisory restrictions on combining them. In those cases, the Board should permit the U.S. subsidiaries of the insurance operation to be held outside of the bank subsidiary’s IHC, and *vice versa*. This would not be unlike a scenario in which a U.S. BHC may own some foreign subsidiaries under its BHC and some foreign subsidiaries under its U.S. bank subsidiary. If another country were to require that all subsidiaries in that jurisdiction be held under a single holding company in that jurisdiction, consolidating the subsidiaries under a single holding company—especially if owned by the U.S. bank—could be inconsistent with U.S. substantive and procedural banking law restrictions on the foreign subsidiaries of U.S. banking organizations.

Lastly, the Board should permit FBOs that operate more than one independent business line in the United States, such as a U.S. retail banking operation and a separate wholesale and investment banking and broker-dealer operation, to elect to establish separate

¹⁷⁶ See 12 C.F.R. Part 243 (Regulation QQ, implementing Section 165(d) of Dodd-Frank); 12 C.F.R. § 243.2(p) (“*Subsidiary* means a company that is controlled by another company...”) and § 243.2(c) (“A company controls another company when the first company, directly or indirectly, owns, or holds with power to vote, 25 percent or more of any class of the second company’s outstanding voting securities.”).

¹⁷⁷ See, *e.g.*, Proposal § 252.2(c)(2) (“*Separate operations*. If a foreign banking organization owns more than one foreign bank, the Board may apply the standards applicable to the foreign banking organization under this part in a manner that takes into account the separate operations of such foreign banks.”); § 252.202 (noting as a basis for multiple IHCs or other alternative organizational structure the circumstance where “the foreign banking organization controls another foreign banking organization that has separate U.S. operations”).

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IHCs for each such independent business or group of businesses, so long as each operates through separate chains of legal entities and each is regulated as an IHC. This would permit the FBO to maintain a prudent governance and management framework appropriate for the mix of activities and interconnections between its various U.S. operations. In addition, as discussed in greater detail in Part II.B.2, this would have the benefit of permitting the Board to tailor capital (and other) standards applicable to the nonbanking operations of the FBO without altering the capital requirements applicable to the FBO's U.S. BHC subsidiary, to the extent it has one. In some cases, it may even be appropriate to exclude U.S. nonbanking subsidiaries from any IHC requirement.¹⁷⁸ Splitting the IHC, or excluding certain subsidiaries from an IHC, for these purposes should not, however, change the overall threshold calculations for determining whether one or more IHCs should be formed, or which level of Section 165 Standards would apply to the IHCs.¹⁷⁹

(e) FBOs Should Have Flexibility to Adjust their IHC Structure to Minimize Unintended or Unnecessary Restructuring Costs

An FBO may be able to minimize adverse tax, regulatory and other consequences through some simple adjustments to the basic IHC structure. The Board should generally permit these adjustments whenever it appears that the benefits of permitting the adjustment—in avoided restructuring costs, tax efficiency or other avoided consequences—exceed the supervisory and financial stability benefits of not making the adjustments. Providing flexibility for existing investments is especially important, to avoid upsetting the business expectations of FBOs that existed at the time investment decisions were made. Future investment decisions could take the IHC requirement into account as one factor in the decisionmaking process. Some examples of such flexibility include the following:

- The Board should permit FBOs to decide whether or not to include subsidiaries below a de minimis asset or liability threshold in their IHCs, when the supervisory and financial stability benefits of including the subsidiary in the IHC would be small. At a minimum, an FBO should be permitted to hold existing small subsidiaries outside of an IHC at the FBO's election on a "grandfathered" basis, in order to reduce restructuring costs for preexisting subsidiaries. In our view, a \$1 billion asset threshold would be an appropriate measure of materiality.¹⁸⁰
- We presume, and the Board should clarify, that an FBO would be permitted to designate one (or more, per Part I.C.2.d) existing U.S. subsidiaries to serve as its IHC(s), including an existing BHC. The Board should further clarify that IHCs can be either pure holding companies or operating companies in their own right.

¹⁷⁸ See, e.g., Part I.C.2.j below.

¹⁷⁹ See Part I.D below (addressing our recommendations regarding what assets and subsidiaries should be excluded from threshold calculations under the Proposal).

¹⁸⁰ Cf. Board Reporting Form, Financial Statements of U.S. Nonbank Subsidiaries Held by Foreign Banking Organizations—FR Y-7N (requiring quarterly reporting of nonbank subsidiaries with total assets of \$1 billion or greater).

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- We support the Proposal’s flexibility in permitting a variety of organizational forms for the IHC, including a corporation, general partnership, limited partnership, limited liability company, etc.¹⁸¹ The choice of legal form for an IHC may have significant tax consequences, and we urge the Board to give the maximum possible flexibility to an FBO in its choice of structure. We also encourage the Board to consider permitting an IHC to be a foreign legal entity, where the FBO can give the Board sufficient comfort that the foreign jurisdiction of organization would not affect the Board’s supervisory authority or interfere with relevant insolvency or resolution considerations.
- The Board should permit an FBO to establish one or more U.S. holding companies above the IHC (that are not themselves regulated as IHCs or BHCs) where (i) adverse tax or other consequences could be significantly mitigated with an additional corporate layer, (ii) the IHC is in compliance with the final rule, and (iii) the top U.S. holding company is not an operating company and does not directly or indirectly hold interests in operating companies outside of the IHC. Such a structure would be useful in circumstances where, for example, an FBO has significant goodwill or other intangibles at the top U.S. parent level that would be disallowed under regulatory capital calculations. So long as a strong IHC is present in the U.S. chain, the existence of such a top-level holding company should not have any material effect on the safety and soundness of the IHC.

- (f) FBOs Should Have the Flexibility to Exclude from Their IHCs U.S. Subsidiaries that Serve as Holding Companies for Non-U.S. Entities

Some FBOs may hold certain non-U.S. subsidiaries through an ownership chain that includes one or more U.S. subsidiaries between the FBO parent and the non-U.S. subsidiary. Such ownership structures may arise for historical reasons—e.g., because of an acquisition by an FBO of U.S. BHC or other U.S. company that had non-U.S. subsidiaries—or because other operational or business connections logically link the U.S. and foreign operations. For example, some FBOs coordinate and support their Latin American operations from New York or other U.S. offices due to the natural synergies between the two regions (e.g., similar time zones), and as a result at least some FBOs have established Latin American subsidiaries through U.S. legal entities. Compelling these FBOs either to hold their non-U.S. operations under a U.S. IHC subject to local U.S. capital and liquidity requirements or to engage in potentially complicated and costly multi-jurisdictional legal restructurings to move these non-U.S. subsidiaries under a non-U.S. ownership chain would seem to be a punitive result for structures that had been established under the Board’s prior regulatory framework for FBOs.

Non-U.S. subsidiaries held under an FBO’s U.S. subsidiary, and the relevant U.S. subsidiary itself, should be excluded by rule from the IHC requirement so long as the U.S. subsidiary is a non-operating holding company. For other situations, such as when a U.S. operating company (such as an IDI, broker-dealer or asset manager) has non-U.S. subsidiaries, the Board should permit exclusion of the U.S. operating company and its non-U.S. subsidiaries from the IHC requirement on a case-by-case basis so long as the FBO can demonstrate that such an exclusion is consistent with the purpose of the IHC requirement. Alternatively, the Board

¹⁸¹ See 77 Fed. Reg. at 76,639.

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could permit the IHC to disregard the non-U.S. subsidiaries for purposes of computing the capital, liquidity and other requirements applicable to the IHC.

(g) Subsidiaries of an FBO's U.S. Branches Should Be Treated as Part of the Branch and Remain Outside of the IHC

The preamble to the Proposal helpfully confirms that the Proposal would not require an FBO "to transfer any assets associated with a U.S. branch" to the IHC.¹⁸² In some cases the assets of a branch will include shares of operating subsidiaries of the branch or similar interests held under authority of the relevant licensing regime of the branch.¹⁸³ As assets of the branch network, the shares of operating subsidiaries or permissible minority investments of an FBO's branch should not be required to be moved into the IHC. Many branch subsidiaries are integral to the operations of the branch such that it would be both illogical and counterproductive to separate them from the branch office (e.g., a limited liability company holding a DPC asset acquired in satisfaction of a loan made by the branch, a trust preferred securities or asset backed securities issuer, or a commercial paper conduit).¹⁸⁴ While some other branch subsidiaries may be more complex than asset holding or funding vehicles (e.g., a subsidiary investment adviser that advises a proprietary fund), the scope of the activities of these subsidiaries is limited by the powers of the branch, and therefore these activities should be regulated as part of the branch, consistent with the applicable laws and regulations of the branch's licensing authority. If a branch subsidiary becomes troubled, it would look first to the U.S. branch, and then the parent bank, rather than transmitting stress to other nonbank subsidiaries held outside of the U.S. branch network.

We recognize that the Board has historically taken the position that an operating subsidiary of an FBO branch is treated as a subsidiary of the FBO for purposes of the permissible activities limitations in Section 4 of the BHC Act. For that purpose, the fact that a subsidiary is held as an operating subsidiary of the branch is effectively disregarded in determining whether the activities of the subsidiary are permissible for the FBO (or require prior notice or approval, etc.). That treatment under the BHC Act would continue to apply if branch operating subsidiaries and minority interests are excluded from the IHC requirement. And in our view, the contexts are distinguishable, since the IHC requirement does not relate to permissibility of activities but rather relates, among other things, to ownership structure and regulatory capital requirements.

At the very least, existing branch operating subsidiaries and minority investments should be grandfathered, and new branch operating subsidiaries and minority investments should be presumed excluded, with the Board having the option to require movement of a branch operating subsidiary or minority investment into the IHC on a case-by-case basis.

¹⁸² See 77 Fed. Reg. at 76,638.

¹⁸³ See, e.g., 12 C.F.R. § 5.34(c) (OCC operating subsidiary rule applies to operating subsidiaries of federally licensed branches); New York Department of Financial Services, Foreign Branches and Agencies Establishing Operating Subsidiaries: Guidance Letter, dated June 4, 2001.

¹⁸⁴ See also Part III.B.3.f for a discussion of conduits that provide funding for an FBO's U.S. branches.

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(h) FBOs Should Be Permitted to Exclude U.S. Subsidiaries with Full, Unconditional Parental Guarantees

U.S. subsidiaries whose obligations are supported by full, unconditional guarantees from their parent bank or one (or more) of its U.S. branches are in much the same position as an FBO's U.S. branches. Although technically separate legal entities, these subsidiaries are inextricably tied to their parent bank by the strength of the guarantee, so that the default of a guaranteed subsidiary would also represent the default of the parent. When a strongly capitalized FBO is willing to put its full and unconditional support behind one or more of its U.S. subsidiaries, the Board should permit the FBO to exclude those subsidiaries from its IHC and instead regulate them as if they were a part of the same legal entity as the parent bank.¹⁸⁵

(i) Merchant Banking and Other U.S. Subsidiaries Engaged in or Holding Nonfinancial Assets Should Be Excluded from the IHC Requirement

We support the Proposal's exclusion from the IHC requirement of subsidiaries held under authority of Section 2(h)(2) of the BHC Act and the Board's Regulation K. And we agree that such subsidiaries typically are not integrated into the financial activities that an FBO conducts in the United States and therefore that it would not be required by the purpose of the IHC requirement to compel FBOs to transfer their investments in such entities into the IHC. However, we believe that this principle should be applied more broadly to include other types of ownership interests that are similar in nature. These would include, at a minimum, subsidiaries held under the FBO's merchant banking authority under the GLBA and subsidiaries acquired in satisfaction of debts previously contracted in good faith. As in the case of 2(h)(2) subsidiaries, these types of subsidiaries typically are not integrated in to the FBO's financial activities, and it would be unnecessary and—in our view—inappropriate to force FBOs to restructure their ownership interests in such companies to transfer them into an IHC.

Similarly, we would urge the Board to exclude real estate, oil and gas and other investments and subsidiaries held pursuant to an FBO's grandfather rights under the IBA and the BHC Act. These subsidiaries and investments have become limited in number and scope over time since passage of the GLB Act, and allowing FBOs to continue to own them directly outside of an IHC would be consistent with the overall purpose of the IHC requirement and the original purpose of grandfather rights under the IBA.

Our suggestions for excluding the foregoing types of entities would similarly apply to any U.S. holding companies or other holding vehicles between the relevant entities and the FBO. So long as these investments and their holding companies are held outside of the IHC's chain of control, and the parent FBO is taking appropriate capital charges against the investments in accordance with home country capital standards, they should not present a significant threat to the safety and soundness of the FBO's IHC or branches, or to the financial stability of the United States.

¹⁸⁵ For example, the subsidiary would be permitted to rely on the capital of its parent bank, rather than being separately capitalized under an IHC, and would have its liquidity position regulated as if it was a branch.

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- (j) For US. Subsidiaries of Foreign Financial Subsidiaries, the Board Should Permit FBOs to Apply for Exemptions from the IHC Requirement

FBOs should, upon application, be permitted to exclude U.S. subsidiaries of foreign financial subsidiaries from the FBO's IHC so long as such U.S. subsidiaries (i) do not form a substantial part (for example, 25%) of the foreign financial company's overall business, and (ii) where their exclusion from the IHC would not have a material effect on U.S. financial stability. This would permit, for example, FBOs with financial affiliates that operate independently from the primary banking operations of the FBO to avoid imposing unnecessary burdens and costs on the affiliated financial company's U.S. operations.

3. *Foreign Government-Owned or Controlled Entities That Control FBOs Should Be Exempt from the IHC Requirement*

Consistent with Board precedents granting sovereign wealth funds and other government-owned entities exemptions from Section 4 of the BHC Act, the Board should also give appropriate relief to FBOs in which a sovereign wealth fund or other government entity has a controlling interest, so that entities "controlled" by the sovereign wealth fund or other government entity in the United States outside of the FBO's banking group would not be required to relocate into the FBO's IHC.¹⁸⁶ The same policies that justify relief from the activities restrictions of the BHC Act—and the exclusion of section 2(h)(2) companies from the IHC requirement—justify an exclusion for the nonbanking operations of SWFs.

4. *Conclusions Regarding the Need for Flexibility and Exemptions from the IHC Requirement for FBO Ownership and Organizational Structures*

In our view, the extent of the foregoing areas where we believe FBOs should be granted flexibility to own subsidiaries and investments outside the IHC structure proves the difficulty of implementing such a requirement. The areas we have identified based on initial feedback from our members no doubt underestimate the total number and types of exemptions that would be necessary to avoid undue disruptions to the way FBOs conduct their U.S., home country and global operations. Especially in light of the other infirmities in the IHC requirement as a general concept, as outlined in Part I.A, we would respectfully suggest that the complexities associated with granting exemptions and relief provide another reason for the Board to reconsider the IHC requirement and instead adopt a more tailored approach focused on the actual systemic risks posed by SI-FBOs.

D. Adjustments to the Calculation of U.S. Assets

We are encouraged to see that the Proposal, in calculating the combined U.S. non-branch assets of an FBO for purposes of determining whether to impose the IHC requirement,

¹⁸⁶ In addition to SWF investments, a number of FBOs are currently "controlled" by sovereigns. Unlike SWFs, which require exemptions from the Section 4 of the BHC Act to engage in certain nonbanking activities in the United States, sovereigns themselves are not "companies" under the BHC Act and therefore are not subject to its requirements.

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would eliminate balances and transactions between U.S. subsidiaries that would be eliminated in consolidation. This approach will remedy some of the difficulties that arose last year during the Office of Financial Research's ("OFR") first round of assessments on financial companies with more than \$50 billion in U.S. assets,¹⁸⁷ and would be consistent with the Board's proposed assessment rule for large BHCs and nonbank SIFIs, which also would eliminate U.S. intercompany balances and transactions.¹⁸⁸ We encourage the Board to provide full transparency in its calculations of assets, and to remain open to discuss any technical issues that may arise.

Additionally, we believe an accurate measure of an IHC's systemic footprint in the United States should also exclude intercompany balances and transactions between U.S. subsidiaries and U.S. branches and agencies. If the purpose of the asset threshold is to measure the exposure of the U.S. economy and U.S. financial system to the IHC, then intercompany exposures between the IHC and its affiliated branches and agencies should not be counted, since they merely represent the allocation of assets between the various affiliates and offices of an FBO, and not exposures to other, nonaffiliated participants in the U.S. financial system. For similar reasons, transactions between the IHC's subsidiaries and its non-U.S. affiliates should be eliminated, because, again, the assets do not represent connections to other, nonaffiliated participants in the U.S. financial system, but simply represent intragroup claims on resources.

Other appropriate adjustments to the U.S. non-branch assets calculation would track certain of the suggested discretionary exclusions from the IHC requirement described above. For example, just as certain U.S. companies that own non-U.S. subsidiaries should be excludable from the IHC requirement, the assets of such U.S. companies and their non-U.S. subsidiaries should not be included in the non-branch assets calculation. Similar treatment would be appropriate for subsidiaries of branches, guaranteed U.S. subsidiaries, foreign government-owned subsidiaries, and nonfinancial subsidiaries (e.g., merchant banking investments).

¹⁸⁷ Last May, the OFR commenced its first round of assessments on BHCs with over \$50 billion in U.S. assets and FBOs with over \$50 billion in U.S. assets pursuant to its final rule implementing Section 155 of the Dodd-Frank Act. See Financial Research Fund, 77 Fed. Reg. 29,884 (May 21, 2012) (to be codified at 31 C.F.R. Part 150). In many cases, unfortunately, the confirmation statements the OFR provided to FBOs overstated the amount of their U.S. assets and provided no information regarding the methodology or accounting adjustments used for the calculations. To the extent FBOs were able to determine what accounted for those overstatements, they determined a number of mistakes were made, including failure to eliminate inter-company items, counting the equity of a subsidiary as an asset of the parent while also counting the subsidiary's total assets, counting the assets of minority owned entities at 100%, rather than reflecting the FBO's actual share of ownership, and other issues. See, e.g., IIB Letter to Cyrus Amir-Mokri, Assistant Secretary for Financial Institutions, Department of the Treasury, Regarding Financial Research Fund Assessments of Foreign Banking Organizations (June 22, 2012); IIB Letter to Giancarlo Brizzi, Acting Director, Office of Financial Management, Department of the Treasury, Regarding Financial Research Fund Assessments (June 11, 2012); IIB Comment Letter on the Notice of Proposed Rulemaking Regarding Assessment of Fees on Large Bank Holding Companies and Nonbank Financial Companies Supervised by the Federal Reserve Board To Cover the Expenses of the Financial Research Fund (Mar. 2, 2012).

¹⁸⁸ See Supervision and Regulation Assessments for Bank Holding Companies and Savings and Loan Holding Companies With Total Consolidated Assets of \$50 Billion or More and Nonbank Financial Companies Supervised by the Federal Reserve, 78 Fed. Reg. 23,162 (Apr. 18, 2013) (the "Assessment NPR").

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Finally, certain asset classes that serve mainly as stores of liquidity and excess capital and do not represent a systemic risk to U.S. financial stability should be excluded from the calculation of an FBO's non-branch assets and liabilities for purposes of the IHC requirement threshold and other relevant asset thresholds (e.g., for application of enhanced liquidity, risk management or capital requirements). Cash and U.S. Treasury securities that FBOs may hold in the United States for many reasons, including as a hedge against currency risks or simply as a low-risk store of excess U.S. dollar revenues from the FBO's worldwide operations, should be excluded.

Similarly, although not specifically an IHC issue, the U.S. branches of many FBOs maintain significant reserves on deposit at Federal Reserve Banks.¹⁸⁹ Such reserves should not be counted for purposes of calculating whether an FBO's combined U.S. assets have crossed any applicable asset size thresholds. Such reserves consist of high quality assets and enhance the stability of an FBO's U.S. operations. FBOs should not be penalized with increased regulatory burdens for conservative reserve policies or their choice to store excess liquidity and capital in the United States.

E. Source of Strength Implications

The Board should clarify that an IHC would not be expected to serve as a "source of strength" for its non-IDI subsidiaries in the traditional sense applied by the Board to BHC support of U.S. IDI subsidiaries. The primary role of the IHC should be to serve as a source of strength for its U.S. IDI subsidiaries (if any) and to provide a "last resort" source of capital and liquidity in the event of an insolvency proceeding or orderly liquidation authority ("OLA") resolution involving part or all of the FBO's U.S. operations.¹⁹⁰ Indeed, in the case of any IHC that is a BHC, a source of strength obligation in support of non-IDI operations could run counter to the BHC's source of strength obligations under existing law.

F. An Alternative Approach to the IHC Requirement: Optional Use of a Virtual IHC

In lieu of requiring FBOs to create an actual top-tier U.S. legal entity to serve as an IHC, the Board could achieve many of its purposes in proposing the IHC requirement, without imposing unnecessary restructuring exercises, through a "virtual" holding company (a "virtual IHC") that applies the Section 165 Standards to an FBO's U.S. operations. Although a virtual IHC would not remedy the fundamental flaws of the IHC requirement, it could reduce some of its ancillary drawbacks, because there would be no need to restructure an FBO's holdings of U.S. subsidiaries, and the FBO would therefore not incur the potentially significant costs of restructuring or risk triggering adverse tax, capital and other regulatory consequences.

Because some FBOs may prefer to organize a single holding company structure over their U.S. subsidiaries, the Board could grant FBOs the option of either (i) voluntarily

¹⁸⁹ As of the third quarter of 2011, FBOs held over half of all reserves at Federal Reserve Banks. See William Goulding and Daniel E. Nolle, Foreign Banks in the U.S.: A Primer, Board International Finance Discussion Paper No. 1064 at 16 and Fig. 1 (Nov. 2012).

¹⁹⁰ See, e.g., Title II of Dodd-Frank.

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measuring and reporting capital and liquidity held at the FBO's major U.S. subsidiaries under Basel methodologies as if an IHC existed, or (ii) establishing an actual IHC. This approach might be especially attractive for FBOs with multiple independent business lines that operate in the United States through separate corporate entities and chains of control—such as full U.S. retail banking operation operated through one or more U.S. IDI subsidiaries, and an independently managed wholesale and investment banking operation operated primarily through subsidiary U.S. broker-dealers and asset managers.

An FBO opting to adopt a virtual IHC structure would calculate, measure and report its capital and liquidity as if its U.S. subsidiaries were consolidated under an IHC, but no legal entity holding company would actually exist to consolidate the FBO's equity holdings in its various U.S. subsidiaries. To the extent the FBO's virtual IHC failed to satisfy the Board's capital or liquidity standards, the FBO could provide additional capital or liquidity directly to one or more of its major U.S. subsidiaries.¹⁹¹ In order to give FBOs flexibility to deploy their capital and liquidity in the manner they determine to be most efficient and effective in promoting the safety and soundness of their U.S. operations, the Board should permit FBOs with virtual IHCs the flexibility to choose where to locate capital and liquidity among the material entities within their U.S. operations. This allocation would be transparent to the Board and would be evaluated in the supervisory process.

The Board, which already has supervisory and examination authority over an FBO's U.S. subsidiaries, could specify the reporting and examination requirements it expects a virtual IHC to meet, including, *e.g.*, independent audits of major subsidiaries, capital plans showing how the FBO expects to manage capital at each subsidiary and among its subsidiaries, and liquidity planning and other risk management requirements the Board proposed to impose on IHCs.

In addition to ongoing supervisory oversight of the FBO's combined U.S. operations, the Board and the FDIC would have the opportunity to regularly evaluate whether the virtual IHC was organized in a manner that permits capital and liquidity to be used throughout the FBO's U.S. subsidiaries in the course of reviewing an FBO's resolution plan, and could mandate tailored stress testing to ensure that capital and liquidity would be available in times of stress (by, for example, modeling the effects of a stress scenario on each of an FBO's material U.S. subsidiaries and testing their ability to obtain support from other U.S. affiliates or from non-U.S. operations). The Board could also require FBOs to establish a single officer or management committee as the single point of contact or center of responsibility for all of the FBO's U.S. subsidiaries.

We acknowledge that a virtual IHC would not have the top-tier U.S. “point of entry” over all of an FBO's subsidiaries that an actual IHC legal entity would provide in a resolution conducted under OLA. This is unlikely to be an issue for many of the FBOs that would be required to form IHCs under the current Proposal that are of limited significance to the

¹⁹¹ In order to simplify the calculation and reporting requirements, we would suggest that only the FBO's major U.S. subsidiaries would be subject to the virtual IHC calculations—the “material entities” identified by an FBO in its resolution plan submitted pursuant to the Board's resolution planning rule would be an appropriate group of entities. *See* 12 C.F.R. § 243.2(l).

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U.S. financial system and would realistically never be subject to an OLA resolution. Even for FBOs that could pose a threat to U.S. financial stability and therefore might be put into an OLA resolution, there are several reasons why the lack of a “real” legal entity to serve as IHC should not overly complicate a resolution. First, in a circumstance where an FBO’s global operations fail and go into resolution, the preferred entry point for an OLA-style resolution for some institutions will be at the top-tier parent entity. As the Board is aware, the FDIC has been pursuing international agreements and understandings to permit a “single-point-of-entry” resolution mechanism at the international level, with some early success.¹⁹² Second, in most cases, an FBO is likely to have only one or a few systemically important nonbank subsidiaries in the United States. In a circumstance where (i) those subsidiaries could not be resolved through the Bankruptcy Code or other applicable insolvency regime without creating a systemic risk to the U.S. financial system, and (ii) an internationally coordinated resolution was not possible, the FDIC would have authority under OLA to be appointed receiver for those subsidiaries that presented a systemic risk to the United States. If necessary, the FDIC could transfer those subsidiaries into a bridge company to permit the subsidiaries to continue normal operations while it pursues an orderly liquidation. Third, as the Board and FDIC continue their review of successive iterations of FBO resolution plans, the U.S. subsidiaries of FBOs should become even more resolvable through ordinary bankruptcy (or other applicable) insolvency regimes.

¹⁹² See FDIC and BoE Report. At the December 10, 2012 meeting of the Systemic Resolution Advisory Committee, Paul Tucker, Deputy Governor of the Bank of England, stated:

United Kingdom authorities are prepared in principle to stand back and let you execute a resolution of the massive U.S. groups which have massive operations in the UK and to leave it to you to do it, without our stepping in and interfering and grabbing the subsidiaries or the branches or the assets of the businesses that are domiciled in the UK. This is a journey that involves trust. The trust that is based on the standards and foundations which we will continue to need to build. And I say that because we are going to need to build those foundations with countries around the world and where it's important therefore, that we together set an example.

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II. Risk-based Capital Requirements and Leverage Limits for Foreign Banking Organizations and Their Intermediate Holding Companies

Consolidated capital standards have long been a foundational element of the prudential supervision of banking organizations. The IIB supports the efforts of the Basel Committee and other national and international regulatory bodies to improve both the quality and quantity of capital held by internationally active banking organizations, and believes that consideration of an FBO's capital adequacy at the consolidated level is an expected and appropriate aspect of the Board's supervision of the FBO's U.S. operations.

In this respect, we agree with the Proposal's general approach to evaluating the capital adequacy of FBOs themselves. The Board would look to the FBO's home country capital regulation to determine whether this regulation is consistent with the Basel Capital Framework and whether the FBO meets these home country capital adequacy standards at the consolidated level. While we have certain suggestions for how this standard should be administered, we agree with the Board's fundamental approach to the capital regulation of FBOs, which is consistent with the Basel Committee's and the Board's long-standing emphasis on top-tier, consolidated supervision and regulation of banking organizations. In our view, this approach is generally consistent with the statutory directives in Section 165 to focus on the regulation of the consolidated institution, taking into account comparable home country standards.

In contrast, the Board's proposal to apply U.S. bank regulatory capital requirements (including those that are not required by current Basel Committee standards) directly to IHCs, when combined with the Board's proposal for how an IHC must be organized and structured, is inconsistent with international standards and other countries' approaches to capital regulation.¹⁹³ As explained in Part I.A above, we believe the IHC requirement exceeds the Board's statutory mandate and contravenes specific directives in Section 165 to, among other things, take into account comparable consolidated home country supervision. The manner in which bank capital standards would apply to an IHC represents one of the more acute infirmities of the IHC concept.

If the Board were to retain the IHC requirement for FBOs that meet the designated threshold, the Board should recognize that the mandatory nature of the IHC requirement, and the fact that there are likely to be several IHCs that have only nonbank subsidiaries, permit flexibility in the application of capital rules to the IHC. In other words, FBOs that are compelled to create IHCs should not be subject to mandatory capital requirements imposed by the Collins Amendment (Section 171 of the Dodd-Frank Act, and in particular the provision related to BHC subsidiaries of FBOs in Section 171(b)(4)(E)), and those IHCs that are not also BHCs are certainly not statutorily compelled to meet BHC capital requirements. We have set forth below our recommendations for how the Board should further modify the

¹⁹³ The Board's proposal concedes that an IHC-focused host country capital requirement is not contemplated by the Basel Capital Framework. See 77 Fed. Reg. at 76,639. Moreover, the Board itself would not apply capital and leverage standards to the intermediate BHC holding companies of a U.S. BHC separately from those applicable at the top-tier BHC or at the bank subsidiary level. Indeed, we would respectfully suggest that if any type of framework for local host country capital requirements were to be developed, the starting point should be an international agreement through the Basel Committee to ensure international consensus and consistency.

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Proposal's IHC capital requirements to alleviate unnecessary burdens and expense, should the Board proceed to apply an IHC requirement.

A. Risk-based Capital Requirements and Leverage Limits for FBOs

We support the Board's implementation of Section 165 for FBOs insofar as it would look first to the FBO's home country implementation of the Basel Capital Framework and the FBO's compliance on a consolidated basis with home country capital standards. In our view, this approach complies with the Board's mandate in Section 165. We would, however, offer the following suggestions for the Board's administration of this standard (assuming it is adopted as proposed). In Part VI below, we separately discuss our concerns related to the de facto extraterritorial application of U.S. regulatory capital buffers to FBO parents that would result from the early remediation framework triggers.

1. *The Board Should Continue to Make Consistency Determinations on a Case-by-Case Basis, without Unduly Restrictive Comparisons*

The Proposal would require an FBO with total consolidated assets of \$50 billion or more to certify to the Board that it meets capital adequacy standards at the consolidated level under standards established by its home country supervisor that are consistent with the Basel Capital Framework. Alternatively, if the FBO's home country standards are not consistent with the Basel Capital Framework, the FBO may demonstrate to the Board's satisfaction that it meets standards consistent with the Basel Capital Framework.

When the Board evaluates an FBO's certification or other demonstration that it meets capital adequacy standards at the consolidated level that are consistent with the Basel Capital Framework, we assume that the Board will—consistent with historical practice in analogous contexts—be flexible in evaluating consistency. Rather than require a point-by-point equivalence between the FBOs' capital standards and the Basel Capital Framework, the Board should look for basic consistency with the material elements of internationally agreed standards. Further, the Board should be similarly flexible in taking into account deviations from the Basel Capital Framework that are not material to the Board's policy objective of protecting U.S. financial stability. Moreover, to the extent that the U.S. standards deviate from the Basel Capital Framework (even if stricter), the point of comparison for the Board's consistency analysis under the Proposal should remain the Basel Capital Framework, not U.S. implementation of the Basel Capital Framework. Home country implementation of the Basel Capital Framework will naturally vary from country to country because the framework is an internationally agreed upon set of standards that is left to individual nations to adopt through their own regulations. The Board should respect the implementation choices made by individual jurisdictions, unless the Board finds that the inconsistencies have a material impact on U.S. financial stability.

For example, we would expect that the types of divergences identified in the Basel Committee's October 2012 consistency assessments of the EU's adopted and proposed regulations implementing the Basel Capital Framework would not prevent the Board from finding that FBOs headquartered in the EU were subject to consistent consolidated capital

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standards under Section 165.¹⁹⁴ Specifically, the Basel EU Compliance Report noted that, although the EU implementing regulations complied with 12 of the 14 key assessment categories, they were “materially noncompliant” with respect to two components of the framework: (i) the definition of capital, including the scope of the definition of Tier 1 common equity and the treatment of minority interests, and (ii) the implementation of the advanced approaches as it relates to the treatment of sovereign debt exposures. On balance, these divergences are minor and are expected to have only a negligible impact on the capital ratios of EU FBOs.¹⁹⁵ Overall, the Board’s policy mandate under Section 165 is to ensure heightened capital standards are applicable to FBOs, and this is accomplished by confirming implementation of the material elements of Basel in an FBO’s home country (as the Basel III standards already require increased levels of capital) regardless of minor deviations from technical provisions.¹⁹⁶

Indeed, if the Board were of the view that the types of divergences identified in the Basel EU Compliance Report would be inconsistent with a determination of consistency under Section 165, then our concerns regarding U.S. territorial capital approaches to U.S. nonbank subsidiaries of FBOs would be magnified immensely.

A reasonable approach to consistency determinations will also be important in order to ensure that this component of the Section 165 Standards complies with the principle of national treatment and competitive equality. The Basel Committee’s compliance report evaluating the U.S. implementation of the Basel Capital Framework also identified a material inconsistency with respect to the implementation of the Basel II securitization framework in the U.S. advanced approaches rule.¹⁹⁷ U.S. BHCs calculating their capital ratios under the U.S. advanced approaches rule will not be required to demonstrate that their capital ratios are strictly consistent with all components of the Basel Capital Framework; the Board should not hold FBOs to a higher standard of consistency.

2. *The Board Should Establish a Standard Procedure before Imposing Conditions or Restrictions on the U.S. Operations of an FBO*

The Proposal provides that if an FBO could not provide the required certification or other demonstration of compliance with capital standards consistent with the Basel Capital

¹⁹⁴ See Basel III EU Consistency Assessment (Level 2) Preliminary Report: European Union (Oct. 2012) (the “Basel EU Compliance Report”).

¹⁹⁵ European Commission Memorandum: Commissioner Michel Barnier’s Reaction to the Basel Committee’s Preliminary Regulatory Consistency Assessment (Oct. 1, 2012), available at http://europa.eu/rapid/press-release_MEMO-12-726_en.htm.

¹⁹⁶ At the same time, the Board should not prejudge the consistency of home country regimes based upon unexpected delays or reconsiderations that arise during the process of implementation. It should be expected that countries will continue to experiment with and refine the implementation of Basel III as problems with the overall framework become apparent. The Board’s focus should be on the overall consistency of a home country’s capital regulations with the Basel Capital Framework, and not on details that are not material to systemic risk.

¹⁹⁷ Basel Committee, Basel III Regulatory Consistency Assessment (Level 2) Preliminary Report: United States (Oct. 2012).

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Framework, the Board may impose conditions or restrictions relating to the U.S. activities or business operations of the FBO. In implementing any conditions or restrictions, the Board indicates that it would coordinate with any relevant U.S. licensing authority.

While we support the concept that the Board would coordinate with any relevant U.S. licensing authority, we would respectfully suggest that the Board should also consult and coordinate with the FBO's home country supervisor, especially in light of the fact that the prerequisite determination would involve a judgment of non-compliance with Basel Capital Framework standards. In addition, the Board should incorporate in its final rule a clearer procedure for such a determination, including a procedure that would give an FBO notice and an opportunity to respond to the Board's findings (all of which would be confidential as part of the bank supervisory process).

3. *The Board Should Not Require FBOs to Meet a U.S. Leverage Ratio*

The Proposal asks in Question 19 whether the Board should require FBOs to meet the current minimum U.S. leverage ratio of 4% on a consolidated basis in advance of the 2018 implementation of the international leverage ratio. In our view, such a requirement would be wholly inappropriate. The Basel III leverage ratio is part of an internationally agreed-upon framework, and there would be no apparent justification for the Board to export a U.S. leverage ratio and impose it unilaterally on FBOs in advance of the international agreement.

B. Risk-Based Capital Requirements and Leverage Limits for IHCs

The risk-based capital requirements and leverage limits that the Board proposes to apply to IHCs embody one of the most problematic aspects of the IHC requirement. We discuss our main policy and legal objections to the IHC requirement, including implications of subjecting IHCs to U.S. bank regulatory capital requirements, in Part I above. In addition, however, we question a basic premise of the Board's proposed IHC risk-based capital and leverage requirements. In noting that "the location of capital is critical," the Board states that "companies that managed resources on a decentralized basis were generally less exposed to disruptions in international markets than those that solely managed resources on a centralized basis."¹⁹⁸ In our experience, and based on feedback from our members, we are not aware of any FBO that "solely managed [or manages] resources on a centralized basis." Many FBOs, including SI-FBOs with significant U.S. banking and nonbanking operations, manage capital both globally and in local jurisdictions in accordance with subsidiary capital needs, market considerations, host country functional regulatory capital requirements, etc. In the United States, this includes not just bank regulatory capital requirements for U.S. bank subsidiaries, but SEC net capital requirements for U.S. broker-dealer subsidiaries.

If the Board were to retain both the IHC requirement and the Proposal's provisions applying separate capital requirements to the IHC, then we believe that the application of such requirements could and should be significantly improved. In making our recommendations below, we note that the Board has broad discretion to tailor the specific capital

¹⁹⁸ 77 Fed. Reg. at 76,639.

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requirements applicable to IHCs because the IHC concept was created by the Board without any specific statutory basis. Indeed, the Board should also have discretion to tailor the capital requirements even with regard to IHCs with IDI subsidiaries, notwithstanding the Collins Amendment, because the Board has mandatorily imposed this structure on FBOs. The Board's policy choice to impose this requirement should not be used as a basis to claim that the Board lacks discretion to tailor the related capital requirements.

1. *Only Significant IHCs Should Be Required to Meet U.S. Capital Requirements*

If minimum risk-based capital and leverage requirements are imposed on IHCs, the Board should limit the application of IHC-specific capital standards to those IHCs that present significant risks to U.S. financial stability. The Board has historically maintained that the policy justification for imposing capital requirements on BHCs is to ensure they may serve as a source of strength to their bank subsidiaries.¹⁹⁹ By contrast, the stated policy rationale behind applying capital requirements to IHCs under Section 165 is to protect U.S. financial stability. Since most IHCs would pose no threat to U.S. financial stability and would have an FBO parent available as a source of strength during periods of financial stress, if the IHC requirement is retained, the Board should recalibrate its proposal to apply heightened capital requirements only to IHCs that present significant, demonstrable risks to U.S. financial stability.

At a minimum, an IHC with consolidated assets of less than \$50 billion should not be subject to heightened capital and leverage requirements under Section 165. As discussed in Part I above, applying a \$50 billion threshold for IHCs not only achieves a minimum level of tailoring necessary to avoid application of heightened standards to IHCs that are irrelevant to U.S. financial stability, but also brings the threshold closer to alignment with the principle of national treatment and competitive equality.

This is especially important given the unnecessary, discriminatory costs that will be imposed on IHCs as FBOs seek to comply with multiple home country and U.S. capital requirements. Requiring calculation of capital requirements under multiple capital regimes, with different definitions and standards, will result in significant compliance costs and will unfairly discriminate against IHCs of FBOs as compared to U.S. BHCs. IHCs subject to the advanced approaches may be subject to up to four sets of overlapping and largely redundant capital calculations: (i) home country advanced approaches; (ii) home country Basel I floor (extended indefinitely in 2009)²⁰⁰; (iii) U.S. advanced approaches (or standardized approach depending

¹⁹⁹ Final Risk-based Capital Guidelines, 54 Fed. Reg. 4186 (Jan. 27, 1989).

²⁰⁰ Basel Committee, Press Release: Basel II Capital Framework Enhancements Announced by the Basel Committee (July 13, 2009). The Basel Committee has extended the Basel I floor indefinitely. The Capital Requirements Regulation of the European Parliament and of the Council on prudential requirements for EU credit institutions and investment firms (the "CRR") provides that the Basel I floor will remain in place until December 31, 2017 unless specifically waived for a particular institution by the competent member state authority in consultation with the European Banking Authority. Competent member state authorities will also have the ability to require that the Basel I floor applicable to EU credit institutions and investment firms calculating their capital requirements using the advanced approaches be replaced with a floor based on the CRR's standardized approach. The CRR also directs the European Commission to submit a report to the European Parliament and the Council on whether it is appropriate to extend the application of the floor beyond 2017 to ensure that there is an appropriate backstop to internal models, taking into account

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upon whether the IHC would, by itself, meet the thresholds for use of the advanced approaches);²⁰¹ and (iv) U.S. Collins Amendment floor (initially the Basel I general risk-based rules to be replaced with the Basel II standardized approach beginning January 2015). IDI subsidiaries of the IHC would also be subject to their own separate standalone capital calculations, and broker-dealer subsidiaries will be subject to the SEC's net capital rule. In addition, the mechanics of the two floor calculations differ materially.²⁰² This unnecessary complication and duplication could prove prohibitively costly and burdensome for FBOs with smaller U.S. operations, which will face strong incentives to close or reduce the size of U.S. subsidiaries in favor of conducting operations through their branch network (or abandoning U.S. operations altogether).

As described above, the Board's proposal to impose U.S. capital requirements on FBOs' U.S. operations is contrary to the policy of international coordination and cooperation that defines the Basel Capital Framework. If every country took the Board's approach, major internationally active U.S. BHCs and FBOs would be faced with having to conduct multiple layers of capital calculations for each of potentially dozens of jurisdictions in which they operate. If the Board ultimately determines, notwithstanding the considerations discussed above, to impose these requirements on IHCs, it should limit their application to those IHCs that actually may present a risk to U.S. financial stability.

2. *The Board Should Permit Flexibility to Establish Separate IHCs for an FBO's Bank and Nonbank Subsidiaries*

The Proposal would require an FBO to establish a single IHC above both its IDI subsidiaries, if any, and its nonbank subsidiaries. Accordingly, any IHC with an IDI subsidiary would be a BHC and would apparently be subject to the Collins Amendment requirement (beginning in 2015) that BHCs satisfy the minimum leverage and risk-based capital standards that are generally applicable to depository institutions. However, there is no statutory mandate in

international developments and internationally agreed standards. See Proposal for a Regulation of the Parliament and of the Council on Prudential Requirements for Credit Institutions and Investment Firms—Text of Political Agreement, Interinstitutional Files 2011/0202 (COD) (Mar. 26, 2013), Art. 476, available at <http://register.consilium.europa.eu/pdf/en/13/st07/st07747.en13.pdf>.

²⁰¹ An IHC that would not meet the advanced approaches thresholds by itself would likely have incentives to opt in to the advanced approaches, as its parent FBO is likely to be using the Basel advanced approaches. However, to the extent that the U.S. advanced approaches diverge (whether materially or not) from the Basel III standards, an IHC would be subject to redundant, yet inefficient, capital calculations and would significantly benefit from applying the same rules (*i.e.*, home country capital standards) as its parent FBO.

²⁰² The Basel Committee stipulates that banking organizations subject to the advanced approaches calculate a floor based on the minimum capital requirement as determined under Basel I, including certain adjustments for capital deductions and add-ons, and multiply that number by 80% (the level of the floor). The resulting number is compared with the minimum capital requirement under the advanced approaches (again including certain capital deductions and add-ons), and the difference between the two numbers must be added back into the risk-weighted asset calculation for the advanced approach. By contrast, the Collins' Amendment floor provision in the U.S. advanced approaches rule requires a subject banking organization to calculate two capital ratios: one based on the current Basel I-based rules (to be replaced by a standardized approach effective January 2015) and one based on the U.S. advanced approaches rule (including certain adjustments to the total capital numerator). U.S. banks then must report the lower of the two ratios.

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the Collins Amendment specifically or in the Dodd-Frank Act generally that requires an FBO to establish an IHC or a BHC subsidiary above any U.S. IDI subsidiary. As such, through creation of a new IHC mandate, the Proposal would expand the Collins Amendment's applicability beyond its intended scope.²⁰³ In our view, it would be inappropriate, and certainly not required by the Collins Amendment, for the Board to extend the provisions of the Collins Amendment to IHCs based on the Board's newly created IHC requirement, whether or not an IHC owns a U.S. IDI. Therefore, we believe that the Collins Amendment requirements need not apply to an IHC created in compliance with the Proposal, and the Board should have flexibility to tailor the capital requirements of IHCs to reflect the differences between U.S. BHCs and FBOs with U.S. operations.

If, however, the Board determines to apply the Collins Amendment to all IHCs with IDI subsidiaries, then to address this unnecessary consequence of the proposed IHC requirement, the Board should permit an FBO to establish separate IHCs above its U.S. bank and nonbank operations.²⁰⁴ This would allow the Board to make appropriate modifications for an IHC that does not own a U.S. bank subsidiary while adhering to more prescriptive minimum capital ratio requirements for IHCs that would be BHCs.²⁰⁵ It would also permit the FBO to maintain a prudent management and governance structure appropriate to its mix of U.S. activities and the extent of interconnections between them.²⁰⁶ Because the IHC concept is one that the Board created without specific statutory authority or direction in Section 165, the Board retains broad discretion to adapt the concept for the circumstances of individual FBOs and the systemic risks that they present.

In summary, we believe that the Board has flexibility to modify the capital standards applicable to IHCs, whether or not they have an IDI subsidiary, and do not believe the Collins Amendment presents a binding constraint on that flexibility. However, if the Board were to take the view that the Collins Amendment is binding on IHCs with IDI subsidiaries, then it should grant FBOs the flexibility to create two IHCs—only one of which would be subject to the Collins Amendment—and should modify the capital standards that would apply to the IHC holding an FBO's nonbanking subsidiaries as described below. The remaining discussion in this Part suggests various ways in which the Board could grant such flexibility in the design of IHC capital requirements.

²⁰³ The Collins Amendment was included in Dodd-Frank specifically to protect the safety and soundness of IDIs. It was described by the Chairman of the FDIC as not applicable to FBOs outside the United States—rather, only to their intermediate BHC subsidiaries. See Letter from FDIC Chairman Sheila Bair to the IIB, dated May 21, 2010.

²⁰⁴ It would not be inconsistent with the letter or the spirit of the Collins Amendment for the Board to permit an FBO to organize separate IHCs—one above its U.S. bank subsidiary (if any) and the other above its U.S. nonbank subsidiaries—since both IHCs would be subject to supervision and regulation under Section 165.

²⁰⁵ For FBOs without any U.S. IDI subsidiaries, the Board's discretion with respect to IHC capital requirements would, of course, not be constrained by the Collins Amendment. As one such example, a non-BHC need not apply the Collins Amendment floor calculation, as the statutory language would only apply such requirement to IDIs, depository institution holding companies and FSOC-designated nonbank SIFs. See Dodd-Frank § 171(b).

²⁰⁶ See Part I.C.2.d above.

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3. The Board Should Tailor IHCs' Capital Requirements to Account for Home Country Capital Requirements and Parent Capital Position

To the extent the Board were to retain an IHC-level capital requirement, it should take into account an FBO's consolidated capital, its home country capital regime and the capitalization of its U.S. subsidiaries in determining the appropriate level of capital to be held in the United States. SI-FBOs operating in the United States would already be subject to enhanced prudential standards on a global consolidated basis under the Proposal, and those with U.S. bank subsidiaries are currently subject to the proposed capital requirements at the level of their bank subsidiaries. Moreover, most FBOs operating in the United States have been closely scrutinized by the Board in a rigorous applications process that focuses in large part on the FBO's ability and willingness to provide capital support to its U.S. operations in times of stress. The Board's SOSA ratings, which play a fundamental role in the applications process and the ongoing supervision of FBOs with U.S. operations, are a valuable tool that the Board has long used to evaluate the availability and strength of an FBO parent's support for its U.S. operations in times of stress.

To the extent that IHC risk-based capital and leverage requirements are retained in the Board's final rule, we would urge the Board to reduce the proposed capital requirements for IHCs that demonstrate to the Board that their parent FBO is strongly capitalized and both willing and able to support the capital of the IHC. This showing would not require a formal or legal guarantee by the FBO parent (in contrast to our proposal to exclude subsidiaries with full, unconditional guarantees from strongly capitalized parents from the IHC altogether), but instead would be supported by a demonstration responsive to the Board's concerns expressed in the Proposal (i.e., regarding any legal or practical limitations on the FBO parent's ability to support the U.S. IHC). The demonstration of strongly capitalized status could also be accompanied by other factors, such as being subject to comprehensive consolidated prudential supervision by the FBO's home country supervisor.

4. The Board Should Modify Leverage Ratio Requirements for IHCs

(a) The Distorted Risk Incentives Caused by Introduction of a Leverage Ratio

Most FBOs are not currently subject to leverage ratio requirements with respect to their U.S. nonbank operations; as a result, application of a leverage ratio would force IHCs to reassess the capital costs of their activities and potentially restructure their operations or reduce or end altogether certain activities. Not only would FBOs face the inevitable costs associated with restructuring their operations to comply with the U.S. leverage ratio, but they would also face distortionary incentives created by a leverage ratio imposed on a local, geographic basis—especially for those FBOs whose U.S. operations are not led by banks.

For example, IHCs with concentrations of low-risk assets may be constrained by the leverage requirement at a capital level well above that required to satisfy their risk-based capital requirements. Conversely, the leverage requirement may not impose any meaningful constraint on relatively higher-risk institutions (in particular, since the U.S. leverage ratio as

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currently formulated does not address off-balance sheet risks). As a result, the application of leverage ratio requirements could have the perverse effect of incentivizing an IHC with a low-risk profile to minimize its holdings of low risk assets and pursue riskier lending and other business strategies in order to manage its leverage capital constraints. We urge the Board to be flexible in its application of the leverage ratio in order to minimize these inefficiencies and distorted incentives particularly in relation to non-bank entities and/or IHCs that house only nonbank entities.

As we discuss in depth in Part I.A.9.f above, the indirect application of a leverage ratio to the U.S. broker-dealer subsidiaries of FBOs through an IHC is one of the more troubling aspects of the Proposal. Because the leverage ratio makes no adjustments for credit risk or liquidity, it would substantially raise the cost of trading, market-making and financing low-risk, highly liquid securities such as U.S. Treasuries and government and agency backed securities. These issues are exacerbated by the application of the leverage ratio at the sub-consolidated, IHC level, where an FBO's broker-dealer assets are likely to make up a substantial proportion of the IHC's total assets. Unless the Board provides some relief from the punitive effects of the leverage ratio on broker-dealer activities, the increased capital costs to FBOs will create powerful incentives for them to modify, reduce or abandon their broker-dealer activities in the United States, to the detriment of the U.S. financial markets and financial stability.²⁰⁷

(b) Leverage Ratio Deductions for IHCs

One of the most important areas for modification would be the use of a modified leverage ratio for IHCs, especially for those without bank subsidiaries. The leverage ratio for IHCs could be modified in several ways to accommodate low-risk activities of broker-dealers and other subsidiaries that would be most adversely affected by a leverage ratio. For example, the leverage ratio for these IHCs should exclude from the total assets calculation U.S. Treasury and agency securities and claims secured by U.S. Treasury and agency securities, as well as other highly liquid and low risk assets (*e.g.*, assets that would be eligible as highly liquid assets for purposes of the liquidity buffer calculation—*see* Part III below). The Board should also exclude repurchase and reverse repurchase transactions and securities lending and borrowing, which are inherently low risk activities due to their high level of collateralization and their protections from an automatic stay in bankruptcy.

The need for these types of modifications is evident in light of the large number of FBOs whose U.S. broker-dealers operate as primary dealers. Of the current 21 primary dealers, a majority are broker-dealer subsidiaries of FBOs. These firms provide a valuable service by acting as market-makers in U.S. government securities, and as a result they maintain a large inventory of securities that are directly and unconditionally guaranteed by the U.S. government, its central bank or a U.S. government agency. Such exposures are risk-weighted at zero percent under the current and proposed risk-based capital rules, consistent with the Basel Capital Framework—meaning no risk-based capital must be held against these assets because

²⁰⁷ Also, as previously noted, any reconsideration by a U.S. broker-dealer subsidiary of an FBO is likely to result in the broker-dealer taking on riskier assets than the Treasuries and other U.S. government securities it now holds, which would also increase concentration of ownership of such assets and decrease their liquidity.

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they are highly liquid and highly unlikely to default. However, under the proposed leverage ratio requirement for IHCs, these extremely safe assets would attract the equivalent of a 50% risk weight because an IHC would need to hold 4% of the face amount of such exposures in Tier 1 capital to satisfy the Proposal's base leverage ratio requirement (without taking into account the buffer imposed by the early remediation triggers and any prudential surplus held by the bank to avoid breaching the minimum ratio or activating an early remediation trigger). Accordingly, under the Proposal, most FBOs with U.S. subsidiary broker-dealers that act as primary dealers would see their leverage capital requirements substantially and immediately increase. Such an increase is likely to lead some FBOs' broker-dealer subsidiaries to reconsider operating as a primary dealer, increasing concentration in the market and potentially adversely impacting the liquidity of, and spreads on, U.S. government securities.

(c) Harmonization of Leverage Ratio Calculations to Eliminate Redundant, Overlapping and Inconsistent Leverage Ratio Calculations

Another significant area of concern in relation to both IHC risk-based capital and leverage requirements is the duplication and potentially inconsistent calculation methodologies that would result from needing to calculate consolidated IHC capital ratios in accordance with U.S. bank regulatory capital regulations as well as in accordance with the parent FBO's home country bank regulatory capital regulations (insofar as the IHC would be incorporated in the consolidated capital calculations of the parent FBO). This concern cuts across multiple capital ratios and calculation methodologies, as discussed further in Part II.B.5 below.

For example, application of U.S. leverage ratios to IHCs would heighten the burdens of maintaining an IHC subject to consolidated capital requirements. The inconsistencies between the U.S. leverage capital requirements and the Basel III Framework's leverage ratio will require FBO parents of IHCs to create redundant, overlapping systems to ensure compliance with multiple leverage ratios applicable to their U.S. operations. If the Board compels all IHCs to comply with a leverage ratio, it should, at a minimum, permit non-BHC IHCs to comply with a leverage ratio calculated according to home country standards consistent with the Basel III principles, rather than imposing an additional, inconsistent standard.²⁰⁸

Indeed, Basel III contemplates that the Basel III international leverage ratio would be the general standard for all internationally active banks. To the extent that national jurisdictions wish to impose additional requirements, they should do so with respect to their own institutions and not with respect to an arm of an international institution that is subject to its own home country implementation of the Basel Capital Framework.

(d) Timing Considerations

If the Board were to apply the U.S. leverage ratio rather than only the international leverage standard, presumably the application of this requirement would commence

²⁰⁸ The exclusion of particular low risk assets from the leverage calculation for non-BHC IHCs discussed in the prior section could be readily applied at the end of the base leverage calculation performed according to home country standards.

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in July 2015. This would not be consistent with the internationally agreed phase-in period for the international leverage standard, and therefore introduces significant additional burdens sooner than would be applicable under international agreements. To reduce these unnecessary burdens, any leverage ratio requirement for IHCs should be implemented according to the phase-in schedule set forth in the Basel Capital Framework.

5. *The Board Should Permit the Harmonized Application of Home Country Regulatory Capital Calculation Methodologies for the IHC Risk-Based Capital and Leverage Calculations*

In addition to the leverage ratio harmonization discussed above, the Board should take steps to modify its standard BHC capital framework to minimize inconsistencies and duplication for IHC risk-based capital requirements. One area where such modifications would be highly appropriate is in the model review and approval requirements under the Board's advanced approaches risk-based capital methodology.²⁰⁹

IHCs that would be mandatorily subject to the advanced approaches under the Proposal or that choose to opt into the advanced approaches should have the flexibility to (i) apply the advanced approaches as implemented in their home country rather than be required to develop alternative systems and models to comply with the U.S. implementation of the advanced approaches and (ii) continue to use their home country approved models, rather than be required to seek Board approval of their existing models.

The U.S. advanced approaches rule diverges in certain material respects from the Basel Capital Framework.²¹⁰ Specifically, the treatment of securitization exposures in the advanced approaches rulemaking proposed by the federal banking agencies in June 2012, which eliminates the use of the ratings-based approach, has been identified by the Basel Committee as materially noncompliant with the Basel Capital Framework. The Proposal effectively requires IHCs that would be subject to the advanced approaches to incur the expense of developing new models and controls to apply the supervisory formula approach to their securitization exposures that are subject to the ratings-based approach for purposes of determining the parent FBO's consolidated capital requirements. Imposition of this additional burden cannot be justified on supervisory grounds because the benefits of models required under the U.S. advanced approaches are effectively limited by the Collins Amendment floor provision in light of the fact that such an IHC will simultaneously be required to apply the more conservative simplified supervisory formula approach set forth in the standardized approach to the same exposures. The securitization framework is one example of the many divergences between the U.S. rules and the Basel Capital Framework which impose significant compliance costs on FBOs that must develop and maintain overlapping, largely duplicative models and systems.

More generally, it is widely expected that the generally applicable Basel I/Basel II standardized rules will be the binding ratio under the Collins Amendment floor for many institutions, especially those not subject to CCAR stress testing requirements (an expectation

²⁰⁹ See 12 C.F.R. Part 225, app. G.

²¹⁰ See Basel Committee, Basel III Regulatory Consistency Assessment (Level 2) Preliminary Report: United States (Oct. 2012).

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supported by the federal banking agencies' quantitative impact studies of the U.S. advanced approaches rule).²¹¹ As a result, it would remove significant burdens and enhance capital management efficiency if IHCs were permitted to use the same advanced approaches systems, models and criteria applicable to the FBO parent under home country rules. It is unlikely that allowing IHCs such flexibility would have a material impact on the capital held by an IHC subject to the Collins Amendment.²¹²

6. *The Board Should Permit IHCs Flexibility to Comply with the Capital Planning Rule*

IHCs would be part of global consolidated banking groups, and therefore would operate under significantly different assumptions regarding capital planning than would top-tier U.S. BHCs. In the normal course of their capital planning, IHCs would be required to take into account considerations that are not relevant to their U.S.-headquartered counterparts, such as the financial condition of their parent foreign bank and developments in their parent foreign bank's home country. In addition, as privately held U.S. subsidiaries of FBOs, they would approach questions regarding sources and distributions of capital from a perspective that is significantly different from that of their publicly traded U.S.-headquartered counterparts.

Given these fundamental differences between, on the one hand, the operations of an IHC as part of a corporate group and, on the other hand, the top-tier BHC of a consolidated global banking organization, it would be illogical to focus capital planning solely on a banking organization's U.S. operations. Forcing an FBO to undergo a capital planning exercise for its U.S. operations in strict compliance with the Board's capital planning rule for U.S. BHCs would also create redundant and unnecessary costs and distract management from efficient operation of the global company. We strongly urge the Board to adapt its proposal to require IHCs to comply with an amended capital planning rule that provides greater flexibility for IHCs unless the Board has a reasonable basis to conclude that the FBO parent's capital planning process is deficient or it is unable to serve as a source of financial strength to the IHC, subject to the criteria set forth below.

Instead of simply applying the capital planning rule to IHCs, the Board should first rely on home country capital planning as it applies to an FBO's U.S. operations, unless the Board has demonstrable concerns that the parent FBO will not be willing or able to serve as a source of strength for its U.S. subsidiaries.²¹³ Naturally, the Board's process for evaluating an FBO's global capital plan will require close consultation and coordination with appropriate home

²¹¹ See Board, Summary Findings of the Fourth Quantitative Impact Study, Feb. 24, 2006.

²¹² The Collins Amendment floor would not apply to IHCs without bank subsidiaries. As noted above, if the Board chooses to apply regulatory capital adequacy rules to IHCs, it should not be constrained by the Collins Amendment to apply them in exactly the same way they are applied to IHCs that are BHCs. For these reasons, the Board should have discretion to accept compliance with home country capital calculations, including home country advanced approaches models, as a way to avoid duplication and improve efficiency.

²¹³ Reliance on home country capital planning is critical in this area, since the Board would be overstepping its supervisory authority if it sought to establish and impose redundant global capital planning standards on an FBO's top-tier parent without regard to whether the home country standards are comparable.

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country supervisory authorities, and the Board would be entitled to expect that the results of the FBO's home country capital plan demonstrate that an FBO's U.S. operations will be adequately supported in times of stress.²¹⁴ If the Board determines that the FBO's global capital planning process is clearly deficient, or that the results of its capital plan and stress testing give rise to justifiable concerns that the FBO would be unable to adequately support its IHC in times of stress, it could condition the ability to pay dividends back to home office on additional, U.S.-specific capital planning and stress testing or impose other requirements.

Avoiding a programmatic imposition of the Board's capital planning rule on IHCs would be especially important in view of the fact that the Board has effectively used the capital planning rule to impose a stressed Tier 1 common equity capital ratio requirement of 5% on U.S. BHCs. Imposition of this requirement—which exceeds the internationally agreed-upon minimum capital requirements in Basel III—on an IHC, a wholly owned subsidiary of an FBO, would be highly inappropriate. FBOs should have flexibility to structure their IHC capital in the most efficient manner they choose, and requiring an additional common equity buffer for a wholly owned subsidiary (as would result from prudent avoidance of common equity tier 1 capital falling below 5% in a medium-term stress horizon) would be unduly restrictive.

7. *Application of a “D-SIB” Surcharge to IHCs Whose Parent FBOs Are Designated as “G-SIBs” Would Be Unnecessary*

The Proposal indicates that the Board could consider applying a quantitative risk-based capital surcharge on IHCs that it deems to be systemically important banking organizations in the United States (“D-SIBs”). The proposal notes that any such a surcharge would be aligned with the Basel Committee's D-SIB regime and would be proposed in a separate, future rulemaking.

As there is no particular proposal set forth at this time for the imposition of a D-SIB surcharge on IHCs, we would simply make three observations.

- First, the Basel Committee's G-SIB and D-SIB surcharges are part of the internationally agreed upon response to issues of systemic risk and SIFIs. The IHC requirement is a new proposal, outside of the Basel Capital Framework and much broader in scope. If the Board retains an IHC requirement and associated capital standards for some subset of the FBOs operating in the United States, it should be viewed as an alternative to, rather than additive to, the D-SIB framework developing at the international level.
- Second, a D-SIB surcharge would not be appropriate for a subsidiary of an FBO that is considered a G-SIB under Basel III and home country capital standards. Any G-SIB subject to increased capital surcharges would by definition be strongly capitalized and therefore have the financial strength to support its IHC subsidiary. Absent a specific determination by the Board that the parent FBO would be unable—notwithstanding its

²¹⁴ Indeed this demonstration of FBO parent support illustrates a critical distinction with U.S. BHCs. Top-tier U.S. BHCs may not be able to access the third-party investor market for additional capital in times of stress. The IHC, however, is by definition more likely to be able to call upon a pool of capital at its parent or affiliates.

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compliance with G-SIB capital surcharges—to support its IHC subsidiary, there should be no reason to impose a D-SIB surcharge on an IHC subsidiary of a G-SIB. Indeed, the U.S. operations will already be applying the higher G-SIB consolidated surcharge to all of their risk-weighted assets and therefore a separate inconsistent surcharge would be unnecessary.

- Finally, we note that, notwithstanding our arguments in this letter, if the Board were to impose the standards under the Proposal as released, both the early remediation requirements and the capital planning under stressed scenarios would effectively impose an additional capital buffer. Therefore, a D-SIB buffer for a wholly owned subsidiary of an FBO would be unnecessary.

8. *The Board Should Adapt IHC Capital and Leverage Requirements to Recognize that FBOs May Appropriately Support Their U.S. Operations through Debt Financing, Parent Guarantees and Keepwell Agreements as well as Equity Investments*

The Proposal's focus on capital requirements fails to recognize that an FBO can effectively fund its U.S. operations with other forms of parental support, such as long-term debt, parent guarantees and keepwell agreements. Regardless of whether an FBO chooses to make equity investments, provide debt financing, provide a parent guarantee or enter into a keepwell agreement on behalf of its U.S. operations, it is acting as a source of strength by providing assets to support the obligations of its U.S. operations.²¹⁵

Both the favorable tax treatment of debt as opposed to equity and the capital treatment of subsidiary investments, among other factors, may make debt a more efficient funding mechanism than equity. Resolution authorities have discussed holding company debt as being essentially “capital” in a liquidation scenario.²¹⁶ In a significant deviation from the Basel Capital Framework, the federal banking agencies have proposed to exclude otherwise qualifying debt instruments from Additional Tier 1 capital, which would further limit the funding options available to FBOs that would be compelled to capitalize an IHC under the Proposal. Accordingly, if the proposed IHC capital requirements are retained, we urge the Board to modify the requirements applicable to IHCs to permit the inclusion of debt financing in the IHCs regulatory capital.

Similarly, in any IHC capital and leverage requirements, the Board should permit IHCs to include contingent capital instruments in their Tier 1 capital calculations to the extent consistent with home country implementation of the Basel Capital Framework. Especially for a wholly owned subsidiary, inclusion of such instruments would be fully consistent with the financial stability objectives of the Board and would be especially useful because the parent FBO

²¹⁵ In other words, the amount of equity capital at an IHC, in contrast to that of a top-tier U.S. BHC, is not indicative of the full loss-absorbing resources available to an IHC. Internal debt structures are much more likely to be able to be restructured into equity, or to absorb losses without insolvency even without being restructured, than U.S. top-tier BHCs that must access or negotiate with third-party investors.

²¹⁶ See FDIC-BoE Report.

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holder of the contingent capital instruments is not likely to bring litigation or exhibit intransigence when an event occurs converting the instrument into equity.

In addition, as discussed above in Part I.C.2.h, the Board should recognize that IHCs whose obligations are supported by full, unconditional guarantees from their parent bank are effectively in the same position as an FBO's U.S. branches. Much like an FBO's U.S. branches, IHCs with parent guarantees are inextricably tied to their parent bank by the strength of the guarantee, so that the IHC's default would also represent the default of the parent. When a strongly capitalized FBO is willing to put its full and unconditional support behind an IHC, the Board should not require the IHC to meet the proposed capital standards for IHCs. The Board should provide similar relief from the proposed IHC capital requirements for those IHCs that benefit from keepwell agreements that provide that the parent FBO will maintain a given level of investment in the IHC.

9. *Adoption of the Proposal May Require FBOs to Raise Additional Capital rather than Simply Reallocate Existing Capital Resources*

Contrary to the assertions that the Proposal would not require FBOs to raise additional global capital, we believe that the Proposal will cause FBOs and their subsidiaries to raise and hold additional capital. In particular, the Proposal may require FBOs that are subject to standalone home country capital requirements which do not permit inclusion of capital held in consolidated subsidiaries to raise additional capital rather than simply reallocate more of their existing capital resources to their IHC.

In contrast to the federal banking agencies' existing and proposed capital regulations, both the current Capital Requirements Directive (the "CRD") governing the capital adequacy of EU credit institutions and the Capital Requirements Regulation and Capital Requirements Directive IV (collectively, "CRD IV/CRR"), which will implement the Basel III reforms in the European Union, require all EU banking organizations to meet capital adequacy standards on both a standalone (parent-only) and consolidated basis.²¹⁷ Parent-only capital requirements are calculated without taking into account capital trapped in subsidiaries. Under the CRR, competent authorities (which may be either the relevant member state supervisor or the European Central Bank for EU credit institutions subject to the single supervisory mechanism under the proposed EU Banking Union) would have discretion to provide institution-specific waivers of these parent-only capital requirements. However, such waivers may only be granted where there are no material practical or legal impediments to prompt transfer of the subsidiary's capital back to the parent.²¹⁸ In light of the Proposal's trapping of capital at the IHC, coupled with the imposition of the proposed early remediation buffer requirements (which could restrict an FBO's ability to engage in capital distributions) and the Board's capital planning rule (which effectively requires advance approval of all capital distributions over a nine-quarter planning

²¹⁷ See Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 (relating to the taking up and pursuit of the business of credit institutions (recast)) (OJ L 177/1, June 30, 2006), Art. 70 and 118; Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 (on the capital adequacy of investment firms and credit institutions (recast)) (OJ L 177/201, June 30, 2006), Art. 2 and 22; CRR, Recital 20, Art. 5.

²¹⁸ See, e.g., CRR Art. 6.

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horizon), it is at best unclear whether this condition for waiver of the parent-only capital requirement could be met. Thus for EU FBOs that would be required to downstream additional capital to their newly formed IHCs, the Proposal may in fact require these FBOs to raise additional capital to replace downstreamed funds to the extent they are not able to secure a waiver of home country parent-only capital requirements.

Further, to the extent that an FBO wanted to obtain capital for its IHC from outside investors through the sale of minority interests in Tier 1 or Tier 2 instruments, the Basel Capital Framework would not permit the full recognition of that minority interest at the top-tier FBO level to the extent that the instruments may, in part, represent “surplus” over the minimum capital required at the IHC level.²¹⁹ Therefore, if the United States imposes additional capital requirements on IHCs—such as a leverage ratio, early remediation “buffers”, capital planning buffers, the Collins Amendment floor, and/or D-SIB buffers (to the extent adopted)—which ultimately require greater capital than would otherwise be required under home country rules for a similarly situated entity, the FBO would be discouraged from pursuing this otherwise viable option to increase the capital of an IHC because capital raised at the IHC may not be fully recognized at the FBO’s parent.

Finally, as a practical matter, imposing additional, subsidiary or IHC-level capital requirements will likely require institutions to hold capital reserves above the minimum standards (including any buffers, surcharges, etc.), because prudent capital management requires a firm to hold sufficient additional capital in each institution subject to capital standards to prevent those institutions from breaching the relevant standards.²²⁰

10. *Imposing Consolidated Capital and Leverage Standards on an IHC Will Need to Take Into Account Structures that Raise Unique Issues for FBOs*

Like many other aspects of the Proposal, several complex issues will arise out of treating an IHC as if it were a top-tier U.S. BHC, including for U.S. bank regulatory capital purposes, in light of the fact that IHCs are not, in fact, top-tier entities but rather are typically wholly owned subsidiaries of an FBO parent. For example, an IHC may own a majority interest in a U.S. subsidiary, and the FBO parent may own a minority interest in that same subsidiary (e.g., by investing in preferred stock of a U.S. broker-dealer subsidiary). The appropriate U.S. bank regulatory capital treatment for the IHC of that minority interest is at best unclear, since the U.S. BHC capital rules operate on a consolidated basis and do not contemplate that a subsidiary of a U.S. BHC would be partially owned by a parent company above the U.S. BHC. As a separate but similar example, an IHC may own a minority (but controlling) interest in a subsidiary, and the parent FBO may own a majority interest in that same subsidiary. Because the

²¹⁹ Basel III, Part I.B.4—Minority Interest and Other Capital Issued Out of Consolidated Subsidiaries Held by Third Parties.

²²⁰ See, e.g., Eugenio Cerutti, Anna Ilyina, Yulia Makarova and Christian Schmieder, *Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks*, IMF Working Paper WP/10/247 (Nov. 2010) (concluding that cross-border firms subject to stricter forms of ring-fencing would require more capital at the parent and/or subsidiary level to withstand a credit shock than firms subject to less stringent ring-fencing or no ring-fencing at all).

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subsidiary is consolidated at the parent FBO level, the punitive treatment at the IHC level of a minority interest in an unconsolidated financial company under the Basel Capital Framework and similar rules proposed by the Board would seem anomalous and unwarranted.

The Board should establish a procedure for FBOs and their IHC subsidiaries to obtain clarification of issues such as these that arise from the unique and somewhat contradictory status of IHCs, and in appropriate cases to obtain relief from unduly harsh or punitive regulatory capital consequences of IHC ownership structures.

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III. Liquidity Requirements

The IIB supports the heightened focus on liquidity that has developed in the aftermath of the financial crisis among global bank supervisors and internationally active banks. In hindsight, liquidity risk was underappreciated and liquidity risk management systems were underdeveloped in the period leading up to the crisis, exacerbating its extent and severity. And we understand the Board's concerns regarding the management of U.S. dollar liquidity at internationally active banks, where maturity mismatches between U.S. dollar assets and liabilities could have financial stability implications for the United States in the event of shocks to U.S. funding markets.

However, internationally active banking organizations have implemented substantially more robust liquidity risk management practices in the last few years and the infrastructure that supports market liquidity has also been enhanced. Banking organizations have elevated liquidity risk matters in their corporate governance framework and now routinely engage in liquidity stress testing and maintain and test contingency funding plans.²²¹ Going forward, U.S. and global liquidity will be better monitored and more transparent to management and to home and host country supervisors.

As the Board considers how to construct an appropriate regulatory framework for FBO liquidity risk, we urge it to take into account the enhanced liquidity management practices of internationally active banking organizations and the increased international supervisory focus on liquidity.²²² We therefore support the Board's decision to defer to home country supervision and an FBO's internal procedures when assessing the liquidity position of FBOs with less than \$50 billion in combined U.S. assets. This reliance on home country liquidity stress testing of an FBO's consolidated operations is consistent with Section 165's focus on the regulation of large banking organizations on a consolidated basis, and its mandate for the Board to take into account the extent to which an FBO is subject on a consolidated basis to home country standards that are comparable to U.S. prudential standards.²²³

In contrast, we have serious concerns regarding the Proposal's adoption of a dramatically different approach for regulating the liquidity of FBOs with \$50 billion or more in combined U.S. assets. As discussed in Part I.A.2, in our view the Board's approach is inconsistent with Section 165's focus on the consolidated entity, the Board's statutory mandate to consider whether an FBO is subject to comparable consolidated supervision, and the core policy of national treatment and competitive equality set forth in Section 165's statutory text. Consistent with that discussion, in our view, the Board should revise its proposed approach to liquidity to focus on the liquidity of all FBOs on a consolidated basis and to defer to comparable home country liquidity standards.

²²¹ See, e.g., Joint Trade Associations Letter at B-1.

²²² See, e.g., European Systemic Risk Board ("ESRB"), Macro-prudential Commentaries, European Banks' Use of U.S. Dollar Funding: Systemic Risk Issues (Mar. 2013) (the "ESRB Liquidity Study") (recommending enhanced monitoring of U.S. dollar funding and liquidity and contingency plans addressing potential shocks to U.S. dollar funding markets at European banks).

²²³ See Dodd-Frank § 165(b)(2).

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A focus on the liquidity available to support an FBO's U.S. operations is an appropriate complement to the international movement towards enhanced liquidity management practices and more robust regulatory liquidity standards.²²⁴ However, the Board's proposed approach to regulation of liquidity for FBOs with larger U.S. footprints appears to misinterpret fundamentally the statutory directives in Section 165 and is unlikely to address the Board's core concerns—maturity mismatches with respect to the global U.S. dollar operations of FBOs. As explained below, we are also concerned that it could be both harmful to economic growth and detrimental to financial stability if implemented as proposed—risks that do not appear to be adequately studied or analyzed in the Proposal. In addition, there are a number of ambiguities in the Proposal that we believe must be clarified before its likely effects can be accurately assessed.

A. Treatment of FBOs with Less Than \$50 Billion in U.S. Assets

We agree with and support the Board's decision not to apply U.S. territorial liquidity requirements to FBOs with less than \$50 billion in U.S. assets, appropriately tailoring the Proposal for FBOs with smaller U.S. footprints.²²⁵ And we have no objection in principle to the Board's request that FBOs provide the results of consolidated internal liquidity stress tests or, at the FBO's option, internal stress tests of the FBO's combined U.S. operations.

We do, however, have three specific recommendations regarding implementation of this framework for FBOs with less than \$50 billion in U.S. assets:

- Most FBOs with U.S. operations are subject to home country liquidity stress testing requirements, and of the few FBOs that are not, most likely perform some form of liquidity stress testing of their own accord. These stress tests naturally will vary in their form, structure, content and underlying assumptions. The Board should be flexible in judging compliance with the liquidity stress testing requirement. For example, it should evaluate the consistency of an FBO's liquidity stress tests with the Basel Committee principles for liquidity risk management against the Basel principles themselves,²²⁶ not the United States' eventual implementation of those principles, and should defer to the judgments of home country regulators regarding how to implement those principles.²²⁷ For those FBOs that are not subject to specific home country requirements but have independently implemented stress testing in a manner consistent with the Basel principles, the Board should generally defer to the judgment of their internal risk managers, provided the stress testing is subject to some form of home country validation or is conducted in a transparent manner that permits the Board to form its own judgments about the integrity and validity of the FBO's methodologies. This deference should extend to the format and frequency of the data supplied by an FBO to the Board. The

²²⁴ See, e.g., Basel Committee, Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools (Jan. 2013); Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring (Dec. 2010); Principles for Sound Liquidity Risk Management and Supervision (Sept. 2008). See also FSA, Strengthening Liquidity Standards, FSA Policy Statement 09/16 (Oct. 2009).

²²⁵ Proposal § 252.231.

²²⁶ See Basel Committee, Principles for Sound Liquidity Risk Management and Supervision.

²²⁷ As discussed in Part I.A above, we believe the principles of consolidated supervision and deference to home country regulation should be featured much more prominently in the Proposal.

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Board should not compel an FBO to perform additional stress testing beyond what is required by its home country liquidity stress testing regime and/or what its risk managers determine is prudent, absent a finding (which we would expect to be extremely rare) that the home country stress test parameters or, for FBOs without home country requirements, internally developed parameters, present deficiencies that in turn raise concerns about the FBO's potential threat to U.S. financial stability.

- The Board should take appropriate precautions to protect the confidentiality of home country and internal stress test results provided to the Board, including by treating all stress test results as confidential supervisory information exempt from disclosure under the Freedom of Information Act and, if necessary, entering into confidentiality agreements with the FBO and its home country regulators, as appropriate.²²⁸
- There may be FBOs that are not subject to home country liquidity stress testing requirements and have not implemented internal liquidity stress testing in a manner satisfactory to the Board, or otherwise may be incapable of providing the Board with the required information. We suggest that the Board provide these FBOs with the opportunity to apply for exemptions from or modifications to the automatic 25% due-from limit that would apply to FBOs that do not perform the required stress testing. Such exemptions or modifications will be especially important for cases in which the FBO's liquidity stress testing deficiency has no bearing on U.S. financial stability, which is the exclusive focus of Section 165.

B. Treatment of FBOs with \$50 Billion or More in U.S. Assets

Our most central objection to the proposed liquidity requirements for FBOs with \$50 billion or more in U.S. assets relates to the Board's proposal to require across-the-board localized liquidity buffers on FBOs with larger U.S. footprints. In our view, the proposed liquidity buffer requirement is inconsistent with the Board's statutory mandates under Section 165, and if it is implemented in its current form, we believe it could have significant negative effects on economic growth, financial stability and effective risk management.

We would urge the Board to replace its proposed approach with one that is consistent with the Board's statutory mandates to tailor the Section 165 Standards to reflect actual systemic risks, take comparable home country standards into account and give due regard to the principle of national treatment. We acknowledge that banking organizations need to continue to improve their systems for monitoring internal and external liquidity flows, but the Proposal's territorial liquidity buffer requirement with segregation of internal and external flows is at the very least premature, given the ongoing developments in the industry and regulatory community intended to address liquidity risks. Indeed, most cross-border banking organizations incorporate assumptions into their stress tests wherein the parent and its foreign branches are subject to simultaneous stress and ensure that the overall liquidity buffer maintained by the institution is sufficient to address both home and host country liquidity needs, no matter where the buffer is held. Such an approach would seem far superior to the artificial separation between internal and external cash flows proposed by the Board. In addition, we question the need for a

²²⁸ See 5 U.S.C. § 552(b)(8).

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complex, U.S.-specific methodology for calculating the liquidity buffer as an interim measure pending finalization of the LCR methodology (as we understand the Section 165 liquidity buffer is intended to be). Finally, there are a number of ambiguities in the Proposal that should be clarified in a reproposal to permit affected parties to meaningfully analyze and comment on the proposed requirements.

1. *Summary of the Liquidity Buffer Requirement*

The Proposal would require an FBO to establish separate U.S. liquidity buffers comprised of unencumbered “highly liquid assets” for its IHC and for its U.S. branch network, based on the liquidity needs derived from internally run liquidity stress tests conducted according to principles and guidelines set forth in the Proposal.²²⁹ It sets forth an elaborate method to calculate the required liquidity buffers based on separate calculations of the relevant entity’s internal and external “net stressed cash flow needs”. The Proposal discusses in general terms the types of considerations and stress scenarios that should be addressed, leaving the details of implementation to each individual FBO. It appears, therefore, that the Board intends to allow FBOs to estimate internal and external cash flows based on each FBO’s own internal models.

To the extent these separate, U.S. liquidity buffers are retained, we support the Board’s decision to defer to an FBO’s reasonable assumptions developed as part of its liquidity stress testing process.²³⁰ An FBO should be free to make its own reasonable assumptions regarding, *e.g.*, the use of statistical and behavioral models to predict the behavior of different classes of assets and liabilities, which may vary for a number of reasons, including whether particular assets or liabilities represent intragroup or external claims or whether they belong to the FBO’s branch or its IHC. Of course, any such assumptions would be made in an explicit and transparent way, subject to Board examination. If the Board has specific expectations regarding what assumptions would be appropriate, it should make those assumptions explicit to permit meaningful comment on their likely implications.

As we understand the Proposal, an IHC and its subsidiaries would be required, on a consolidated basis,²³¹ to hold a liquidity buffer inside the United States sufficient to meet its net stressed cash flow needs for a period of 30 days. An FBO’s U.S. branch network would also be required to hold a liquidity buffer sufficient to meet its net stressed cash flow needs for a period of 30 days, but only the first 14 days of that buffer would be required to be held inside the United

²²⁹ See Proposal § 252.226; 77 Fed. Reg. at 76,645.

²³⁰ The Proposal does not explicitly discuss the types of assumptions that would be permitted under the stress testing requirements, but acknowledges that in making baseline cash flow projections an FBO should “use reasonable assumptions regarding the future behavior of assets, liabilities, and off-balance sheet exposures”, which would include a “dynamic analysis that incorporates management’s reasoned assumptions regarding the future behavior of assets, liabilities, and off-balance sheet items in projected cash flows”. Proposal at 76,644. We presume that this acceptance of dynamic analysis based on reasonable assumptions carries over to the conduct of liquidity stress testing.

²³¹ As we read the plain language and intent of the Proposal, the IHC’s liquidity buffer requirement, like the cash flow needs calculation, would be a consolidated concept (*i.e.*, not exclusive to the IHC parent company and without restrictions on where in the IHC or its subsidiaries the buffer is held). If the Board intended otherwise, we would have additional and even more serious concerns regarding the IHC liquidity buffer requirement.

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States; the remainder (days 15 through 30) could be held at its head office outside of the United States, provided that the Board is satisfied that the head office (or an affiliate) has and is prepared to provide sufficient highly liquid assets to the U.S. branch network.

To arrive at the “net stressed cash flow needs” for an IHC or branch network, the Proposal would require an FBO to calculate the relevant entity’s net external stressed cash flow needs and its net internal stressed cash flow needs; the total net stressed cash flow need would be the sum of those two figures. These calculations are subject to a number of adjustments that appear to be intended to achieve particular policy goals. For example, “net internal stressed cash flow needs” would never be permitted to be less than zero, apparently in order to ensure that positive net stressed internal cash flows (e.g., where the entity is, on net, receiving cash flows from its non-U.S. parent and/or U.S. and non-U.S. affiliates) can never offset net external cash flow needs in the short term.²³² Based on our best reading of the Proposal, the resulting liquidity buffer framework can be summarized as follows:

- Each of an FBO’s IHC and its U.S. branch network would be required to maintain a liquidity buffer equal to the sum of its short-term net internal and external stressed cash flow needs.
 - An IHC would be required to hold all 30 days of its buffer inside the United States.
 - An FBO’s U.S. branches would be required to hold their buffer for days 1 to 14 inside the United States, but could hold their day 15 to day 30 buffer “outside of the United States”.²³³
- Both IHCs and branches would separately calculate their short-term (30 day) external (third party) net cash flow needs under stressed conditions.
 - Only external cash flow sources maturing within 30 days would be permitted to offset short-term external cash flow needs.
 - Internal cash flow sources from non-U.S. offices or U.S. or non-U.S. affiliates (including, in the case of an IHC, the FBO’s U.S. branch network, and, in the case of the U.S. branch network, the FBO’s IHC and its subsidiaries) would not be permitted to offset short-term external cash flow needs.

²³² See 77 Fed. Reg. at 76,646 (“The proposal treats these [external and internal] cash flows differently to minimize the ability of [an FBO] to meet its external net stressed cash flow needs with intragroup cash flows.”).

²³³ 77 Fed. Reg. at 76,646. Although there are some internal inconsistencies in the rule text and preamble (§ 252.227(f)(23) refers both to holding highly liquid assets “at the head office” and later to providing assurances that the “company . . . has and is prepared to provide, or its affiliate has and would be required to provide” highly liquid assets to the U.S. branch), we read the Proposal to indicate that the day 15 to day 30 buffer can be held at either head office or another non-U.S. or U.S. affiliate, so long as the FBO can demonstrate that the buffer would be available to the U.S. branches in a time of stress.

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- In addition, each of an FBO’s IHC and its U.S. branch network would be required to calculate its short-term internal cash flow needs under stressed conditions.
 - IHCs would calculate, and hold a buffer against, their net internal stressed cash flow needs arising from transactions between the IHC and its U.S. and non-U.S. affiliates, including the FBO’s U.S. branches.
 - Branches would calculate, and hold a buffer against, their net internal stressed cash flow needs arising from transactions between the U.S. branch network and the FBO’s non-U.S. offices and its U.S. and non-U.S. affiliates.
 - Because U.S. branches would be permitted to hold their day 15 through day 30 buffer at their head office or other affiliates, they would not be required to calculate internal stressed cash flows for that period of time—their buffer for days 15 to 30 would only need to account for external stressed cash flow needs, as if they were a U.S. BHC.
 - Netting of short-term internal cash flow sources and short-term internal cash flow needs would be accomplished in a manner that counts only internal cash flow sources maturing or otherwise available before an internal cash flow need in order to offset that cash flow need.²³⁴
 - Excess short-term external cash flows sources, after netting out short-term external cash flow needs, could be used to offset internal cash flow needs.²³⁵

The overall effect of the Proposal’s liquidity buffer calculations would be to trap liquidity at an FBO’s U.S. branch network and at its IHC, and to prohibit the IHC and U.S. branch network from relying on liquidity available anywhere else in the FBO’s consolidated group to meet expected short-term external cash flow needs under stressed conditions. In contrast, under the Domestic Proposal a U.S. BHC would be required to calculate and hold only one liquidity buffer, against its short-term external cash flow needs under stressed conditions, and could rely on global sources of liquidity to meet those obligations.²³⁶

²³⁴ So, for example, an expected payment from the parent bank on day ten could offset a cash flow need that takes the form of an obligated payment to the parent or another affiliate that comes due on day thirteen, but not an obligated payment that comes due on day eight. This appears designed to create “an incentive for companies to match the maturities of cash flow needs and cash flow sources from affiliates, due to the likely high correlation between liquidity stress events in the U.S. operations and non-U.S. operations of [an FBO].” 77 Fed. Reg. at 76,656. Such “name specific” correlation is greatest between a branch and its home office; correlated stresses would be less likely between an IHC and its parent FBO. Typically, FBO stress testing models provide for these types of correlated stress events.

²³⁵ Although the Proposal does not specifically state this, it appears to be the intended result of permitting net external stressed cash flow needs to be a negative number (and therefore represent a net positive cash flow), while net internal stressed cash flow needs cannot go below zero (and therefore cannot offset external cash flow needs when the two numbers are added together to calculate net stressed cash flow needs). See Proposal §§ 252.227(b) – (d).

²³⁶ As noted above, our understanding of the Proposal and the Domestic Proposal is that liquidity held at a regulated subsidiary, such as a U.S. IDI, would be available to meet the overall requirement for a

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2. *Specific Policy Issues regarding the Proposed Liquidity Buffer Requirement*

(a) *The Proposed Liquidity Buffer Is Unlikely to Address the Board's Core Concerns regarding Global U.S. Dollar Liquidity Shocks*

We understand one of the Board's core concerns motivating its new approach to FBO liquidity risk management and regulation is premised on its concerns about the expanded U.S.-dollar-denominated activities of FBOs across the globe. The Board has observed that FBOs often are more reliant on wholesale funding to finance their global U.S. dollar activities, and that this leads to a maturity mismatch that can cause fire sales and shocks to U.S. asset prices when those U.S. funding markets come under stress. The Board in the recent past has taken steps necessary to prevent a global U.S. dollar liquidity crisis through swap lines established with major central banks. However, we would submit that a territorial approach to regulation of FBO liquidity is an inadequate tool to address the Board's concerns over global U.S. dollar liquidity.

The U.S. dollar remains the world's predominant reserve currency and is relied upon for business and financial transactions worldwide. As a result, FBOs must have access to U.S. dollar funding and must hold U.S. dollar assets to finance these transactions. If the Board makes it more difficult or costly for FBOs to obtain that financing and hold those assets in the United States, it will not curtail the global demand for U.S. dollars (unless, as a result of the decreased supply and higher cost, businesses begin to move away from the U.S. dollar and begin to adopt other reserve currencies). And if international entities cannot readily seek dollar financing through banks that have access to U.S. markets, they may find other ways to fulfill that demand, for example through foreign exchange swaps on non-U.S. exchanges. The Board could even see a return of the Eurodollar market and an increase in dollar lending overseas, which would ultimately give the Board less visibility into dollar-denominated transactions worldwide. The risks of contagion and transmission of global shocks into the United States through trade in U.S. dollars and fire sales of U.S. dollar assets would remain.

The best solution to the risk presented by the U.S. dollar activities of global banks is to reach a global agreement on how to monitor and manage U.S. dollar liquidity on a consolidated basis. On this front, we note the ESRB's recent focus on the U.S. dollar liquidity of European banks, and its recommendations to improve monitoring and contingency planning.²³⁷ Consistent with the ESRB's recommendations to European national authorities, we would suggest the Basel Committee's liquidity framework should be adapted to provide for home

consolidated BHC or IHC liquidity buffer, even if the subsidiary itself is subject to independent liquidity requirements and liquidity stress testing. The only suggestion in the Proposal to the contrary is in a footnote that indicates that "applicable statutory and regulatory restrictions on companies, including restrictions on the transferability of assets between legal entities, would need to be incorporated [into stress tests]." 77 Fed. Reg. at 76,645, n. 64. If the Board has particular expectations regarding where within a consolidated IHC the required buffer may be held, or how liquidity held at U.S. regulated subsidiaries should be counted, it should provide much clearer indications of its expectations with an opportunity for further comment.

²³⁷ See ESRB Liquidity Study. The Study notes that some countries in Europe, such as Sweden and the UK, have proposed to, or already have the power to, set liquidity ratio requirements specific to U.S. dollars on their home country banks. *Id.* at 7.

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country regulations implementing enhanced monitoring, stress testing and contingency planning of U.S. dollar liquidity at the consolidated level, which would be a more effective alternative to addressing the Board's concerns than the proposed territorial liquidity buffers.

(b) The Proposed Liquidity Buffer Fails to Provide National Treatment for FBOs

We have already discussed at some length in Part I the ways the Proposal conflicts with the core U.S. policy of national treatment and competitive equality.²³⁸ In short, the Proposal would impose a different and more burdensome liquidity buffer requirement on FBOs than the Domestic Proposal would impose on U.S. BHCs. Because the Proposal would require an FBO to maintain separate liquidity buffers for each of its U.S. branch network and its IHC, FBOs would be forced to fragment their liquidity among multiple geographic locations and legal entities. Even within the United States, an FBO would be forced to separate its liquidity between its IHC and its branch network. In contrast, under the Domestic Proposal U.S. BHCs would be permitted to maintain a single liquidity buffer for their consolidated global operations.²³⁹ In addition, the Proposal would place significant limits on the ability of an FBO to take account of intragroup funding flows, both across borders and within the United States, that would not apply to U.S. BHCs. In sum, U.S. BHCs would not have to assume that liquidity held in operations in foreign countries was not available to satisfy U.S. domestic liquidity needs nor would they have to assume that liquidity in some entities within the United States would not be available to satisfy liquidity needs of other affiliates within the United States—differences in application that are clearly discriminatory. These differences are likely to lead to higher liquidity requirements for FBOs than for U.S. BHCs both in the United States and for their consolidated global operations.

Separately, the Proposal does not automatically permit FBOs to count home country sovereign debt as highly liquid assets for purposes of the liquidity buffer, even though U.S. sovereign debt automatically qualifies. Qualifying only U.S. government securities as highly liquid assets in the Proposed Rule is inconsistent with national treatment, because a U.S. BHC would automatically be permitted to invest in the obligations of its home government to satisfy its liquidity obligations while an FBO would not. Furthermore, this is inconsistent with the Proposal's SCCL requirements, under which exposures to an FBO's home country sovereign are exempt from SCCLs and, by extension, are eligible collateral that would exempt an exposure to a third party.²⁴⁰

Deferring to comparable home country regulation would remedy these national treatment violations and put FBOs operating in the United States on the same footing as U.S. BHCs, subject to a single set of holding company liquidity regulations applied at the consolidated, global level.

²³⁸ See Part I.A.5.

²³⁹ Certain subsidiaries of U.S. BHCs may be subject to specific liquidity regulations imposed by their functional regulators. These subsidiary level requirements, which would apply equally to FBOs with U.S. functionally regulated subsidiaries, do not change the discriminatory effect of the Proposal's liquidity requirements, which would impose liquidity requirements at the consolidated level for U.S. BHCs and at the sub-consolidated level for FBOs.

²⁴⁰ See Proposal § 252.246(c).

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(c) The Liquidity Buffer Proposal Is Based on an Oversimplified Assumption about the Availability of Liquidity from the FBO Parent

On a conceptual level, the Board's underlying assumption that liquidity for an FBO's U.S. operations will not be available from the parent bank or its home country in times of stress is—in our view—oversimplified and flawed. As noted in Part I.A.9 above, there are strong reputational, contractual and legal incentives for an FBO to support its U.S. operations, especially for a branch whose obligations rank pari passu with the obligations of the domestic branches of the parent bank under its home country legal system. These same concerns would certainly give a home country regulator pause before compelling an FBO to let its U.S. operations fail, as such an action would likely lead to the collapse of the entire institution, especially if the institution is otherwise subject to ongoing stress. This is not an exaggeration; letting operations fail in a major international capital markets locale, such as the United States, would likely stress the entirety of an FBO to the brink of collapse, rather than bolster the non-U.S. operations as the Board assumes.

For just this reason, FBO head office stress testing models typically provide for localized and correlated global stresses, with the goal of maintaining sufficient group liquidity to meet the liquidity needs of the entire group and all of its home country and foreign affiliates. Therefore, contrary to the Board's assumption, liquidity stress testing at many FBOs already assumes that head office and offshore operations will be stressed, and calculates an appropriate buffer that would still allow head office and offshore affiliates to supply liquidity and/or honor internal obligations to U.S. and other operations. Consequently, it is invalid to assume that head office and offshore affiliates will not be able to honor obligations even though they have modeled the ability to do so.

To the extent that the liquidity buffer requirement is meant to provide “gone concern” protections for U.S. creditors and not just “going concern” protections, such concerns would be better addressed in a coordinated international resolution planning process, rather than in a one-size-fits-all rulemaking. As the Board reviews FBOs' U.S. resolution plans, it will have extensive opportunities to evaluate the liquidity risks of an FBO's U.S. operations in a gone concern resolution scenario and would have the ability to impose additional protections through that process. And liquidity stress testing and liquidity buffers should be primarily designed to avoid insolvency and resolution, not only to ensure resources are available in the case of failure.

The Proposal's blanket judgments that home country laws or regulations will limit or block an FBO's support for its U.S. operations, and that home countries lack the capacity or political will to provide support to FBOs based in their jurisdictions, ignore the importance of banks to the economies of other countries in contrast to the much more decentralized banking industry in the United States. The Board should not base a fundamental reform of regulatory policy towards FBO liquidity management on the assumption of no parental or home country support when that assumption is premised on an overgeneralized concern for future inaction. The Board provides no evidence for this overbroad assumption, which results in a one-size-fits-all regulatory construct that penalizes a significant majority of FBOs operating in the United States whose head office and global network would, in fact, supply appropriate liquidity if necessary.

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(d) The Liquidity Buffer Requirement Will Result in the Harmful Fragmentation of Liquidity, Potentially Slowing Lending and Hindering Effective Liquidity Risk Management

We discuss in detail in Part I.A.6 the absence in the Proposal of sufficient analysis of the potential negative macroeconomic and financial stability effects of trapping capital and liquidity locally, including the risk that other jurisdictions could follow the United States' example and take reciprocal actions that would compound these effects by pulling additional liquidity out of the global economy. As the Board notes in its proposal, holding too much liquidity has its own risks because it can hurt the profitability of an FBO.²⁴¹ The Board asserts that the proposed U.S. liquidity buffer requirements are not intended to increase the overall amount of liquidity held by an FBO on a consolidated basis.²⁴² If this is the premise of the Board's policy conclusion, we respectfully suggest that the premise should be tested and analyzed further through an appropriate impact assessment, as it would appear to us almost a certainty that the inability to net across pools of liquidity would force FBOs to maintain higher overall liquidity levels than would otherwise be required.²⁴³ The higher liquidity costs that would result could reduce the participation of FBOs in U.S. financial markets (thereby concentrating those markets in U.S. BHCs, making the markets more susceptible to idiosyncratic and market shocks). It could also have implications for the supply of highly liquid assets needed for financial intermediation in the global economy and may ultimately lead to reduced lending in the United States and globally.

We note that the recently revised Basel III Liquidity Coverage Ratio ("LCR") puts significant limits on a banking organization's ability to take account of liquidity at regulated subsidiaries.²⁴⁴ The imposition of liquidity ring-fencing on subsidiaries and operations in the United States is likely to increase consolidated parent liquidity needs unnecessarily when applying the LCR to the parent organization. The new Basel LCR release would permit liquidity held at a subsidiary or affiliate to count for the parent's LCR only to the extent that the related risks (as measured by the subsidiary or affiliate's net cash outflows in the LCR) are reflected in the parent's consolidated LCR, and it will not permit excess liquidity held at a sub-consolidated level to be counted against the parent's LCR if liquidity transfer restrictions—including regulatory, legal, tax, accounting or other impediments—are in place that would prevent the liquidity from being freely available to the parent in times of stress.

Due to the fundamental importance of assessing the net effects on an FBO's U.S. operations and global liquidity position, we would urge the Board to undertake an appropriate impact assessment of its proposed U.S. liquidity buffers requirement. As the Board has acknowledged in connection with the development of the Basel III LCR, quantitative liquidity

²⁴¹ See 77 Fed. Reg. at 76,643

²⁴² See 77 Fed. Reg. at 76,642.

²⁴³ In addition, smaller pools of assets exhibit higher volatility, and as a result, the sum of any buffers required against multiple small pools would likely be higher than the buffer needed to be held against one large pool of assets. See also Part II.B.9.

²⁴⁴ See Basel Committee, Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools at paras. 36 – 37.

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regulation is a new domain for international bank supervisors and deserves careful analysis and assessment, combined with gradual implementation and testing, to ensure that the new standards do not create unintended consequences. We believe that approach is especially appropriate in relation to the Proposal, since not only would the Board impose new and fundamentally different U.S. territorial liquidity standards on FBOs' U.S. operations, but the ring-fenced nature of the requirements add an extra dimension of concern about unintended consequences and potentially flawed assumptions.²⁴⁵

In our view, not only should the Board test more carefully its fundamental assumption that the Proposal would not require an FBO to increase its global liquidity, but it should also test the implications of the Proposal for the conduct of FBOs' U.S. operations and their contributions to U.S. markets. The Board should publish for public comment the results of this impact assessment—either as part of the rulemaking process for the Proposal or separately—and should take public comments on the impact assessment into account before finalizing the Proposal. In connection with this impact assessment, the Board should also publish a reproposal or further guidance and examples for how the liquidity buffer calculations would work in practice, to resolve the ambiguities noted elsewhere in this Part.²⁴⁶ It will be impossible to conduct a full impact assessment without clear, unambiguous statements of how the liquidity buffer requirement would be applied.

We would also urge the Board to consider further the implications of the Proposal for an FBO's liquidity risk management. As a general matter, required fragmentation of liquidity into multiple independent pools will complicate liquidity risk management. In the current structure of U.S. cross-border banking supervision, FBOs have choices in how they approach liquidity risk management, depending on whether they operate through a largely decentralized and subsidiarized format, or whether they operate more significantly through branches with centralized global liquidity management that addresses home and host-country liquidity needs holistically. Many FBOs operate according to a centralized model, where they apply stress tests to their consolidated organization—including their U.S. operations—under a variety of idiosyncratic and market shocks and maintain a consolidated liquidity buffer of sufficient size to ensure that both parent and host country operations will have ready access to liquidity in times of stress. By forcing FBOs to manage liquidity risk on a territorial and siloed basis for their U.S. branches and U.S. IHC, those FBOs that otherwise conduct banking operations through branches will be required to manage liquidity against local liquidity requirements in ways that will detract from other, enterprise-wide liquidity risk management objectives that proved to be a source of strength for many firms during the last crisis.

²⁴⁵ We would also argue that Governor Tarullo's statements "counsel[ing] caution in trying to construct new regulatory mechanisms from scratch at the international level" because of "little or no precedent of national . . . requirements from which to learn" are equally applicable at the national level. See International Cooperation in Financial Regulation, Speech by Governor Daniel K. Tarullo at the Cornell International Law Journal Symposium (Feb. 22, 2013). At the national level, novel initiatives that attempt complex internal/external and branch/IHC funding restrictions should not be applied on a cross-border basis (i.e., to FBOs) without some quantitative impact study that ferrets out and addresses unintended consequences and significant negative impacts on the FBOs and the U.S. and international markets.

²⁴⁶ See, e.g., Part III.B.2.e below.

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In addition, FBOs would be prevented from using trapped liquidity to address stress in other offices or subsidiaries. There is significant evidence from the financial crisis that mobile pools of liquidity enabled banking organizations to respond more effectively to liquidity pressures.²⁴⁷ Forcing branch networks and IHCs to operate as siloed operations that are funded independently could complicate management efforts to raise and allocate liquidity and funding. (Organizations that have significant host country retail deposit-taking operations would be relatively less affected.) At a minimum, in our view the Board should study carefully the resulting pressures on liquidity risk management and on consolidated liquidity resources, taking into consideration the diversity of FBO business models, to ensure that these pressures will not make certain classes of FBO more fragile.

- (e) Numerous Questions about the Intended Scope and Operation of the Liquidity Buffer Requirement Make It Difficult to Accurately Assess Its Likely Costs and Benefits

In Part III.B.1, we set forth our understanding of how the Proposal would apply the liquidity buffer requirement to IHCs and U.S. branches. However, the number of questions regarding key details in the Proposal make it difficult to accurately assess the costs and benefits of the requirement. For example, confirmation of our reading that IHC liquidity buffers would be calculated and held on a consolidated as opposed to standalone basis is necessary to assess how much liquidity would in fact be trapped inside the United States. Uncertainties regarding the treatment of funding conduits and collateralized external and internal cash flow sources, or whether the definition of highly liquid assets will be expanded to cover additional asset classes, are also critical details affecting any assessment of costs and benefits.²⁴⁸ These and other questions deserve careful analysis and consideration, and we urge the Board to engage the industry more directly regarding their resolution, including through the impact assessment we propose above and through other contacts and discussions with industry. Additional numerical examples of how the Board foresees the liquidity buffer requirement applying in practice, covering a variety of different business models and business practices, would be especially helpful.

- (f) Liquidity Ring-Fencing Is Likely to Complicate Access to Funding and Increase Funding Costs for FBOs

The Proposal appears to have discounted the significant variation in funding costs and access among members of a corporate group. For a variety of reasons, not all members of a corporate group have access to the same amount of cash flow sources at the same or similar prices, and often the ultimate parent and its branches have the best, lowest cost access to funding. By cutting off the ability to use intra-company cash flows to meet external short-term cash flow needs, the Proposal would prevent an FBO (in a manner not imposed on U.S. BHCs) from using the most efficient funding channel for each business or entity and would therefore increase funding costs for the FBO's U.S. and consolidated operations. Consequently, an FBO will be required to reconsider the overall cost-effectiveness of its mix of activities, potentially reducing its overall level of lending and financial intermediation in the United States. Requiring or

²⁴⁷ See notes 112 to 113 and accompanying text.

²⁴⁸ See, e.g., Part III.B.3.

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encouraging multiple entities under the same parent FBO to access separate cash flow sources in the market could also accelerate pressures on funding access and costs for the FBO during a crisis, because of the increased operational and messaging challenges of simultaneously managing funding programs in multiple entities.

3. *Specific Recommendations and Concerns regarding the Liquidity Buffer Requirement*

- (a) The Board Should Adopt an Approach to Liquidity Regulation that Takes Into Consideration Comparable Consolidated Home Country Supervision

Instead of compelling all FBOs with more than \$50 billion in U.S. assets to maintain local liquidity buffers and conform to a single management and governance structure, the Board should evaluate an FBO's liquidity risk management framework—including its compliance with the Basel III LCR requirements when they come into force—on a consolidated basis, and assess whether that framework can effectively complete the management tasks the Board views as essential.²⁴⁹ In our view, the most effective way to tailor any new U.S. territorial liquidity buffer requirements, including rules on matching of internal and external cash flows, would be to impose them only on institutions, or segments of their U.S. operations, for which the Board has determined that the totality of relevant factors (availability of parent FBO liquidity, effectiveness of an FBO's liquidity risk management, FBO compliance with Basel III liquidity standards as implemented by its home country on a consolidated basis, stress testing results for U.S. operations, etc.) justify such a requirement.

Alternatively, although inferior to the first approach, the Board could adopt a process that would exempt well-supervised FBOs that are in compliance with their home country liquidity requirements from the Proposal's specific liquidity provisions in favor of deference to home country supervision and global management of liquidity, with appropriate reporting and assurances to the Board, including reporting describing the FBO's U.S. and—if determined necessary to obtain the waiver—global liquidity position.²⁵⁰ Given the recent progress by the Basel Committee in revising the LCR requirement, we fully expect that most jurisdictions will implement liquidity standards consistent with Basel III, and except in extraordinary circumstances we expect that those standards would qualify as comparable home country regulation for purposes of the Section 165 liquidity standards, obviating the need for U.S. territorial liquidity requirements. We also note that since the financial crisis, European regulators have heightened their own scrutiny of the liquidity risks associated with European banks' use of U.S. dollar funding.²⁵¹ Given the clear signs of progress on multiple fronts, it

²⁴⁹ For example, does the FBO's current framework maintain sufficient liquidity reserves to meet short-term obligations, establish liquidity risk tolerances, review and/or approve business strategies and products in light of their potential liquidity risks, maintain contingency funding plans, and establish specific limits on potential sources of liquidity risk. See 77 Fed. Reg. at 76,643 – 653.

²⁵⁰ For example, the Board could condition waiver of U.S. liquidity requirements on receipt of timely information showing an FBO's global U.S. dollar cash flows and overall liquidity position as reported to the FBO's home country supervisor. Cf. Proposal at 76,644, Question 23 (asking whether the Board should seek global U.S. dollar cash flow data from FBOs).

²⁵¹ See, e.g., ESRB Liquidity Study.

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would be premature for the Board to adopt its own, territorially limited liquidity requirements before other jurisdictions have the opportunity to complete their reforms.

In general, under either approach the Board would first defer to home country regulation of an FBO's global liquidity, with appropriate reporting and assurances to the Board, and most FBOs would be permitted to rely on home country liquidity to meet the cash flow needs of their U.S. operations. However, if the Board determines that there are deficiencies in the quality or timeliness of information it receives from an FBO or its home country supervisors, or if it sees deficiencies in the FBO's consolidated liquidity, and if consultations with home country regulators and/or the parent bank are unable to remedy the difficulties, the Board would be able to administer tailored liquidity requirements under Section 165, including standalone stress testing of the FBO's branches or other U.S. operations, mandatory intragroup liquidity monitoring, limits on "due from" positions or even potential U.S. liquidity buffer requirements. The PRA's recently implemented liquidity regulations take a similar approach, where it will waive the local liquidity maintenance requirements for a UK branch or subsidiary of a non-UK bank if the branch or subsidiary, its parent and its home country supervisor satisfy certain ongoing conditions, including home country supervisory equivalence, cooperation and adequate access to information.²⁵² At a minimum, the Board should permit FBOs that provide ready access to liquidity information and assurances of home office support to apply for reductions in the amount of liquidity that they must maintain in the United States (for example, limiting it to 2 to 5 days of liquidity, enough time to convert liquidity held in other currencies into U.S. dollars and transmit them to the United States and/or move U.S. dollar liquidity held offshore into the United States).²⁵³

(b) If the Liquidity Buffer Requirement Is Retained, It Should Be Revised Consistent with Basel III, Home Country and Other U.S. Liquidity Regimes

The Board's proposed approach to calculating and implementing the liquidity buffer requirement is not consistent with either the original or revised Basel III LCR buffer, and it does not appear to be consistent with other home country liquidity regulations or the liquidity requirements that would apply to an FBO's functionally regulated subsidiaries in the United States. Compliance with multiple, divergent sets of liquidity requirements—for (i) the consolidated FBO's global operations, (ii) the FBO's U.S. IHC, (iii) the U.S. branch network, and (iv) each of the FBO's functionally regulated U.S. subsidiaries—would unnecessarily complicate consolidated liquidity risk management.²⁵⁴

²⁵² See notes 51 and 108 above.

²⁵³ See also Part III.B.3.j below for further discussion of the location of the liquidity buffer.

²⁵⁴ See, e.g., 17 C.F.R. 240.15c3-1; SEC, Interpretation Guide to Net Capital Computation for Brokers and Dealers, 32 Fed. Reg. 856 (Jan. 25, 1967) ("Rule 15c3-1 . . . was adopted to provide safeguards for public investors by setting standards of financial responsibility to be met by brokers and dealers. The basic concept of the rule is liquidity; its object being to require a broker-dealer to have at all times sufficient liquid assets to cover his current indebtedness."); CFTC, Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802, 27,803 – 04 (proposed May 12, 2011) ("[Futures commission merchant ("FCM")] capital requirements . . . are designed to require a minimum level of liquid assets in excess of the FCM's liabilities to provide resources for the FCM to meet its financial obligations as a

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It appears that the Board intends the Proposal's liquidity buffer requirement as an interim measure, pending finalization of the Basel III LCR. While we would support international harmonization of liquidity standards, we respectfully suggest that it is unnecessary to develop a complex, U.S.-specific liquidity buffer methodology for FBOs as an interim measure. Consequently, if the Board were to retain a U.S. territorial liquidity requirement in the final rule, it should at least harmonize the requirement to reflect the revised Basel III LCR—which we expect will become the international standard for home country liquidity regimes—in terms of substance and timing. If, as the Proposal states, the Board intends to implement the Basel III LCR and other liquidity requirements consistent with their international timeline, we see no reason for the Board to complicate matters by imposing another, inconsistent liquidity standard that will take effect after the Basel III LCR begins to be phased in.²⁵⁵

The Board should also work closely with the primary functional regulators of an FBO's U.S. subsidiaries (e.g., FINRA and the SEC for broker-dealers, the OCC for national banks and federal branches, and state chartering and licensing authorities for state-chartered banks and state-licensed branches) to ensure that the Board's liquidity buffer requirements are consistent with and do not interfere with any subsidiary or branch liquidity requirements. It would present unnecessary operational challenges for an IHC to have to calculate its consolidated liquidity spread across its various operating subsidiaries—including, e.g., a U.S. IDI subsidiary or a U.S. broker-dealer—if the liquidity standards of the IHC and of its subsidiaries were subject to different methods of calculating liquidity needs and different definitions of what assets can be included in the liquidity buffer without compelling reasons for the divergence. Given the strong potential for overlap and inconsistency, it is critical that the Board come to an understanding with other U.S. prudential regulators regarding which entities are required to have liquidity buffers, where they must hold them, and what assets can be included in the liquidity buffers.

- (c) The Board Should Permit FBOs to Offset the External Short-Term Cash Flow Needs of Their U.S. Operations Using Intragroup Cash Flows Unless the Board Has Significant, Specific Reasons to Believe that the Intragroup Cash Flows Would Not Be Available under Stressed Conditions

So long as an FBO's internal stress testing demonstrates that liquidity from a parent or other affiliate would remain sufficient and available in a time of stress to meet the liquidity needs of its home country and U.S. (and other relevant) operations, the Board should permit intragroup cash flow sources from that parent or affiliate to offset the short-term external cash flow needs of the FBO's U.S. operations, just as a U.S. BHC is permitted to use liquidity available in any part of its global operations to offset external cash flow needs. Similarly, an

market intermediary in the regulated futures and options market. The capital requirements also are intended to ensure that an FCM maintains sufficient liquid assets to wind-down its operations by transferring customer accounts in the event that the FCM decides, or is forced, to cease operations as an FCM.”).

²⁵⁵ The Basel III LCR is scheduled to come into effect in a phased manner, with banking organizations subject to a 60% LCR requirement beginning January 1, 2015. See Basel Committee, Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools at para. 10. The Proposal's liquidity buffer requirement would not apply until July 1, 2015.

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FBO's U.S. branch network and its IHC should be able to rely on each other as cash flow sources to the extent permitted under applicable law, just as a U.S. BHC is permitted to move liquidity among its U.S. operations. We believe that this standard could be met by most FBOs and that the Board's basic assumption of no assistance from head office or affiliates is flawed. It is particularly implausible to assume that cash flow sources representing obligations due from home office would not be paid when due and available to offset future external cash flow needs where the home office has the legal obligation and operational capacity to repay.²⁵⁶ More generally, it is not clear why third-party cash flow sources (and their attendant credit risk) should be viewed as more reliable sources to address other external cash flow needs than cash flows from related, intragroup sources that have a specific and vested interest in the health of the U.S. operations.

If an FBO's stress testing—which should already be modeling liquidity needs and flows among various affiliates during times of stress—or other factors suggest that liquidity might not always be available from an internal source, the Board could require an FBO to apply a haircut to intragroup funding intended to offset external obligations. If the Board chooses to adopt this approach, it should take a risk-sensitive approach and vary the haircut depending on the strength of the parent.²⁵⁷

(d) Separation of Internal and External Cash Flows Would Interfere with Ordinary Course Financial Intermediation between Affiliates

While we understand the basic source of the Board's concern regarding large due from positions for U.S. branches and IHCs, the bifurcation of internal and external cash flows in the Proposal would put significant pressure on defining the distinction between the two. Bifurcation would have some unusual, and we believe unintended, implications for the ordinary course financial intermediation that the U.S. operations of FBOs regularly perform for other members of their corporate groups.²⁵⁸ Four examples—affiliate clearing activities, centralized hedging, secured securities financing transactions and centralized dollar cash management—identified by our members are set forth below, although we suspect there are many other contexts where the distinction between internal and external cash flows will become complicated.

- *Centralized Affiliate Clearing Transactions.* Financial institutions often centralize membership and clearing through a central counterparty (“CCP”) in a single entity for the entire group, typically a registered broker-dealer and/or FCM. In the case of FBOs,

²⁵⁶ This is yet another reason why liquidity regulations should first analyze the consolidated organization—it would be arbitrary and illogical to assume that other parts of the organization would not pay obligations due to their affiliates or other offices, unless a consolidated liquidity stress test indicates concerns about their ability to pay.

²⁵⁷ The fixed haircut approach adopted in the Basel LCR would be especially inappropriate for intragroup cash flows, since the likelihood of full repayment would be inextricably linked to the unique characteristics of the parent FBO or other affiliate, including, *e.g.*, its home country capital and liquidity position, the applicable home or host country legal regimes, and the quality of home and host country management and supervision.

²⁵⁸ If the Board does intend the liquidity buffer requirement to curtail these activities, or modify the way FBOs conduct them, those intentions should be made explicit and further discussed with an opportunity for public comment.

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U.S.-dollar activities that require clearing and settlement through a U.S. CCP or other clearing and settlement system, such as a stock or futures exchange, clearing house, or derivatives clearing organization (“DCO”), would generally be internally cleared and settled through the U.S. affiliate with membership in the relevant CCP.

When a clearing (CCP-member) affiliate acts on behalf of its affiliate to clear a transaction through a CCP, it becomes obligated (either as principal or as agent and guarantor) to make certain payments to the CCP, including the initial and ongoing payment/delivery, margin and/or collateral requirements.²⁵⁹ To meet these obligations, the clearing affiliate would rely on matched payments from the ultimate booking affiliate. As a result, even though the clearing affiliate is a mere intermediary for two external, offsetting trades (between the booking entity’s client and the CCP), under the Proposal the “internal” exposure would be treated differently than the “external” exposure.

If the Proposal’s internal/external cash flow distinction is retained, these matched trades, collateral and margin flows may not appear matched in the calculation of the liquidity buffer, because (assuming an FBO’s U.S. branch or a subsidiary of its IHC is the CCP member) any cash flow sources due from the booking affiliate would be ineligible to net against the external cash flow need of the clearing affiliate (which could include the initial transaction costs as well as daily margin and/or collateral requirements). As a result, liquidity costs for ordinary course affiliate clearing transactions could rise significantly.²⁶⁰

- *Centralized Hedging of U.S. Customer Transactions.* Local liquidity buffers could make it much more costly for FBOs to hedge customer exposures effectively, because they would have to hold liquidity buffers against any hedges that are run through home office or other non-U.S. affiliates.²⁶¹ For asset classes that are more efficiently hedged outside of the United States (e.g., foreign interest rate swaps, foreign exchange swaps and foreign securities), these additional costs could significantly detract from effective risk management, as the relevant U.S. markets may lack sufficient liquidity to permit an FBO to hedge risks on a cost-efficient basis. Matched back-to-back hedges designed to efficiently mitigate external customer exposures should be exempt from the internal liquidity buffer requirement, in order to encourage efficient and effective hedging strategies.

²⁵⁹ For example, under the U.S. FCM clearing model, an FCM clearing swaps as agent on behalf of an affiliate would combine collateral and margin from the affiliate’s swaps in the same “house” account at a DCO in which it holds collateral and margin related to its own proprietary swaps (unlike its third-party customers, whose collateral and margin are held in a segregated customer account). From the eyes of the CCP, the FCM is the primary obligor for all payment obligations related to its and its affiliates’ swaps.

²⁶⁰ Consider, for example, the liquidity buffer requirements that an FCM might be required to meet in order to cover potential obligations to pay variation margin to a CCP under severely adverse stressed conditions. A potentially enormous amount of liquidity could be trapped at the FCM if it has no ability to rely on cash flow sources from its booking affiliate.

²⁶¹ The inverse is also true: significant burdens would be placed on an FBO’s non-U.S. operations that find it efficient to hedge their customer transactions through the U.S. operations (such as transactions in U.S. securities).

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- *Secured Securities Financing Transactions.* FBOs often use their U.S. subsidiaries or branches to provide access to the U.S. financing markets by engaging in matched back-to-back repo, reverse repo and other securities lending and borrowing transactions. For example, a U.K. broker-dealer may wish to obtain short-term financing for excess U.S. Treasuries it holds on its books. The broker-dealer would repo those securities to its affiliated U.S. branch or IHC, which would then simultaneously repo the securities into the market for cash. Although these transactions present almost no risk to the intermediate entity, which would be standing in the middle of two matched, collateralized obligations, the methodology of calculating internal and external liquidity buffers would prevent the cash due from the affiliate to offset the intermediary's external cash flow need (the obligation to repurchase the securities offered as collateral in the repo).
- *Centralized Dollar Cash Management.* Depending on the details of implementation, a requirement to engage in strict maturity matching could interfere with FBOs that use their U.S. branches to consolidate and clear U.S.-dollar transactions and therefore often have large short-term intragroup cash inflows and outflows unrelated to the overall funding of the U.S. branch. If the final rule retains a requirement to separately calculate and maintain liquidity buffers against internal and external cash flows in some form, the Board should carefully consider what exemptions it may need to prevent the rule from unintentionally interfering with regular cash management operations. For example, it may be prudent for the Board to exclude overnight sweep transactions from the liquidity buffer calculations altogether if kept as cash on hand for the duration of the sweep.

(e) Treatment of Collateralized Transactions

The examples set forth above regarding affiliate clearing and secured securities financing raise another ambiguity of critical importance in analyzing the effects of this Proposal. The Proposal provides no specific guidance on how collateralized external or internal cash flows should be treated under stress tests or with respect to the liquidity buffer. If collateralized transactions are intended to be included in the calculation of the liquidity buffer, the Board should clarify how the different forms of secured transactions should be treated.

Under our best reading of the Proposal as currently drafted, we understand that collateralized transactions could be included in the liquidity buffer calculations if an FBO's liquidity stress tests account for the collateral coming into (or going out of) an IHC or branch as another potential cash flow. For collateral consisting of highly liquid assets that can easily be rehypothecated for cash, we would assume that the receipt of collateral would generally be the equivalent of a cash flow source. For less liquid or more volatile collateral, we would expect FBO stress tests might apply some form of haircut or buffer relative to the fair market value of the collateral. (Of course, more volatile collateral is likely subject to daily margining requirements that would maintain the overall level of collateralization over time.)

As one example, repos and reverse repos collateralized with highly liquid securities generally present very little liquidity risk, because even if a counterparty defaults, the other side of the transaction has either cash or liquid securities it can easily convert into cash. It is not clear from the Proposal whether such transactions, if included in the liquidity buffer calculation, would be treated as essentially matched cash flows (as cash goes out, an offsetting

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flow of cash-equivalent highly liquid assets comes in), whether the collateral received in a reverse repo would be considered part of the liquidity buffer convertible to cash, or if some other treatment would be required.

If the Board intends to defer to FBOs' internal stress testing assumptions regarding the cash flow equivalence of collateral in secured transactions, it should clarify that intention in the final rule. Otherwise, it should publish and invite comment on guidance regarding how secured cash flow sources and needs would be treated under the Proposal. Failure to appropriately account for the value of collateral as a store of value and liquidity could have a chilling effect on FBO participation in variety of low-risk, collateralized markets (including, e.g., the U.S. Treasury repo markets).

- (f) The Board Should Treat Funding Raised by Conduits as External Funding for the Branch or IHC, Even If Not Consolidated under that Specific Entity or Office

Another complication resulting from the need to distinguish between internal and external cash flows arises from the use of conduit entities to obtain market funding. Many banking organizations use offshore special purpose vehicles (“SPVs”) or booking locations to raise secured and unsecured funding from the financial markets. Because cash flows from these entities represent direct fundraising from external sources, there should be no question that they would be treated as external cash flow sources for purposes of the liquidity buffer. However, technical details regarding their operations and legal structures could lead to ambiguity over their proper classification.

For example, some conduits organized in the United States might be “controlled” for BHC Act purposes and therefore, as U.S. “subsidiaries” of the FBO, could be required to be held under an FBO's IHC, even if the conduit's funding is directed towards the FBO's U.S. branch network.²⁶² If the conduit was held under the IHC, external funding it raised for the branch network might be treated as internal under the Proposal for purposes of the U.S. branch network's liquidity buffer, and therefore could not offset the branches' external cash flow needs. In other cases, a conduit intended to raise funding for an FBO's U.S. branch network could be organized outside of the United States for technical legal or regulatory reasons, and therefore might be treated as a non-U.S. affiliate of the FBO parent. In this case, the conduit's cash flows might be treated as an internal cash flow source coming from an offshore affiliate, rather than an external source, and therefore could not offset external cash flow needs.

One example of these funding arrangements would be the SPVs and branches organized in offshore financial centers that FBOs use to issue commercial paper to provide funding for their U.S. operations. For example, some FBOs use their Cayman branch as a conduit to bring funding raised by short-term unsecured commercial paper into the United States. The commercial paper issuer will deposit any cash raised into the Cayman branch on a dollar-for-dollar, term-for-term basis, and the Cayman branch will direct the funding to the FBO's U.S.

²⁶² See Parts I.C.2.a – c above for a discussion of reasons why a BHC Act “subsidiary” might not be held in an FBO's IHC. If a conduit is not controlled under the BHC Act or is not required to be consolidated under GAAP, then it should clearly not be required to be “held” under the IHC.

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branches. The utility of these offshore SPVs and booking locations in providing financing to the U.S. operations of financial institutions has been recognized by the Board, and the Board has accepted reporting of these operations as consolidated with or connected to an FBO's U.S. branch network, despite the fact that for technical reasons the intermediaries must be located offshore.

We urge the Board to look through the corporate legal form of these conduits in light of their underlying purpose—to raise external funding for an FBO's IHC or U.S. branches—and to treat these “cash flow sources” as external funding for the ultimate recipient of the funds raised.²⁶³ Otherwise, a key source of funding for FBOs' U.S. operations would be effectively excluded from the liquidity buffer calculation. Although it may in some cases be possible to restructure the cash flows so that a branch or IHC is issuing commercial paper or notes directly, often intermediate vehicles are necessary due to legal, regulatory, tax or other considerations.²⁶⁴

(g) The Board's Proposed Alternative Approaches to Calculating Internal Stressed Cash Flows Are Inappropriate and Should Not Be Adopted

The Proposal asks for comment on three potential alternative or additional adjustments to the calculation of internal stressed cash flows. Alternative 1 would assume that all funding from head office or non-U.S. affiliates would arrive the day after its scheduled maturity date (to prevent intraday arbitrage of maturity matching); alternative 2 would apply a 50% haircut to all incoming internal cash flows from home office or non-U.S. affiliates (rather than attempting to match maturities within the 30-day period); and alternative 3 would assume that all maturing intra-company cash flow obligations over the thirty-day liquidity buffer horizon would mature and roll off at 100% of par, while none of the maturing incoming cash flow sources would be received (and therefore could not be used to offset any maturing intra-company obligations).

Each of these proposed alternatives is overly prescriptive and would interfere with an FBO's internal liquidity management. Each perpetuates the Proposal's unrealistically negative assessment of an FBO's incentive to honor its obligations to its subsidiaries and branches.

More specifically, we are concerned that alternative 1 could interfere with U.S. dollar clearing operations (where banks take overnight U.S. dollar deposits from their non-U.S. offices and redistribute the cash the next morning) and other overnight or intraday transactions with home office that are necessary for the efficient operations of the FBO. Alternative 2 would appear to leave an FBO that stays neutral in terms of net funding but regularly cycles funding

²⁶³ At the same time, as noted in Part III.B.3.c above, internal sources of liquidity should be permitted to meet the maturing obligations of conduits even if the conduits are treated as external sources of funding.

²⁶⁴ For example, an asset-backed commercial paper conduit is secured with a specific group of assets, and must therefore be established as a separate entity in order to properly isolate the FBO from extra liability should those assets prove insufficient to pay the holders of commercial paper.

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into and out of the United States in a perpetual liquidity deficit.²⁶⁵ And alternative 3 would result in overly punitive liquidity charges, as an FBO would not be permitted to count any intra-company funding expected over the short-term. The Board should rely on its supervision and review of an FBO's stress testing and liquidity management planning rather than mandating specific assumptions about how internal funding flows should be accounted for.

(h) The Board Should Expand the Range of Highly Liquid Assets Eligible for Inclusion in the Liquidity Buffer

The Proposal's current definition of "highly liquid assets" is unduly narrow, including only cash and securities issued or guaranteed by the U.S. government, a U.S. government agency or a U.S. government-sponsored entity. Although the Proposal would allow the Board to specifically approve additional classes of assets, the Board should "preapprove" additional classes of assets in its final rule in order to provide certainty for FBOs as to what additional assets might be used to satisfy the liquidity buffer requirement.

At a minimum, the Board should provide that the assets permitted under the revised Basel III LCR will be permitted assets for purposes of the Proposal's liquidity buffer requirement. The Board should also identify other factors that it would consider in counting additional assets as highly liquid. For example, eligibility as collateral at the Board's discount window should be identified as a positive feature for an asset class that would weigh in favor of approving it as a highly liquid asset.

One especially important asset class the Board should include in the definition of highly liquid assets is stable, high quality foreign sovereign bonds. We urge the Board to include in the final rule a determination that all high quality sovereign obligations would be available to satisfy liquidity requirements under the final rule.

The Basel III liquidity framework broadly recognizes sovereign obligations as appropriate sources of qualifying liquidity, and the Board should do the same. We continue to support the recommendation in the Joint Trade Associations Letter that sovereign debt securities be included in the definition of "highly liquid assets" if they are assigned a specific risk-weighting factor of 1.6 or less under the Board's market risk rules, or if they would otherwise meet the standards for a 20% risk weighting under current Basel I capital rules.²⁶⁶ This standard would be consistent with the inclusion of sovereign debt securities under the Basel III liquidity framework (without any inappropriately restrictive categorization of such assets) and the current U.S. implementation of prior Basel accords, while also conforming to the Dodd-Frank requirement to eliminate reliance on credit ratings. We also support the Joint Trade Associations Letter's recommendation for similar inclusion of securities or obligations of multinational organizations, multi-lateral development banks and central banks in the definition of "highly liquid assets" in the final rule.

²⁶⁵ Alternative 2 would apply a haircut to internal funding used to offset internal cash needs. A haircut approach to intra-company funding sources might be more appropriate in the circumstance where an FBO is counting on internal funding to meet external obligations, as discussed in Part III.B.3.c, above.

²⁶⁶ See Joint Trade Associations Letter at B-9 to B-11; IIB, Comment Letter on the Domestic Proposal at 5.

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The inclusion of sovereign debt and other securities as highly liquid assets in the final rule is appropriate not only because they are, in fact, highly liquid instruments or because their inclusion would bring the Proposed Rule into consistency with the Basel III approach, but also because their exclusion would have a detrimental effect on the markets and liquidity of such instruments. FBOs and U.S. BHCs are significant participants in the markets for sovereign and multinational organization debt. A shift away from using such instruments for fundamental asset-liability and liquidity management purposes would ironically impair the liquidity of such instruments for other market participants. At an absolute minimum, it is essential the Board include the sovereign obligations of an FBO's home country as highly liquid assets.

In furtherance of the statements in the Proposal and the recommendation in the Joint Trade Associations Letter that U.S. government, agency and government-sponsored enterprise debt securities be excluded from the diversification and concentration standards described in the Proposal, we would also recommend that any sovereign or multi-national organization securities that are included under the standards described above be excluded from the diversification and concentration standards described in the Proposal. At a minimum, an FBO's U.S. operations should be subject to more flexible diversification or concentration standards with regard to the sovereign or central bank securities of its home country. The ability to transfer such securities to its parent and the access of the parent to local markets for such securities should alleviate any concern about concentration risks in such country's securities.

(i) **The Board Should Permit an FBO to Hold its Liquidity Buffer in Multiple Currencies**

Although the Proposal's current wording would not prohibit the holding of non-U.S. dollar currencies in the liquidity buffer, the Proposal asks under "what circumstances should the cash portion of the liquidity buffer be permitted to be held in a currency other than U.S. dollars?"²⁶⁷ Restricting eligible currencies to only U.S. dollars would be neither necessary nor appropriate. An FBO should be permitted to hold any currency that is highly liquid and exchangeable to U.S. dollars or for another currency that matches current obligations. Restricting liquidity buffers to U.S. dollars and U.S.-dollar denominated assets would be inconsistent with the Basel III LCR and home country definitions of highly liquid assets (and discount window eligible collateral).

A firm should be permitted to mitigate U.S. dollar liquidity risks with non-U.S. dollar liquid assets that can be swapped back into U.S. dollars (and vice versa), so long as it is done within defined, prudent and approved parameters that consider the market liquidity of the non-U.S. dollar currency. Among other benefits, a mixed currency liquidity buffer would provide helpful diversification. In addition, many U.S. branches and subsidiaries have both U.S. dollar and non-U.S. dollar liabilities. If a branch or IHC's liquidity risk is denominated in another currency, the liquid asset buffer for that risk should naturally be permitted to be in that other currency. The Board should rely on reasonable internal policies and procedures for mixed

²⁶⁷ 77 Fed. Reg. at 76,650, Question 30.

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currency liquidity buffers that account for the costs and risks of relying on currency swaps and the types of assets and liabilities involved.²⁶⁸

- (j) The Board Should Adjust the Location Requirements for Liquidity Buffers and Clarify the Conditions under which Liquidity Buffers Can Be Held Outside of the United States

The Board's expectations regarding the location of an FBO's U.S. liquidity buffers are not entirely clear from the text of the Proposal. However, there are certain apparent location requirements that would be overly prescriptive. To the extent the liquidity buffer requirements remain in the final rule, we have three specific recommendations for adjusting and clarifying the location requirements:

- The Board should limit the requirement that an FBO's IHC or branch network hold its liquidity buffer in the United States to only that portion of the liquidity buffer that would be needed to cover the entity's immediate liquidity needs while the FBO implements an FX swap or other mechanism to transfer the remainder of the buffer to the entity in need of liquidity. Typically arrangements to move liquidity onshore—whether the transfer of U.S. dollar liquidity held offshore, or the use of an FX swap to change non-U.S. dollar liquidity into U.S. dollars—can be established quickly. We believe it would be reasonable to require only 2 to 5 days of liquidity to be held locally in the United States. Under the Domestic Proposal, U.S. BHCs would be permitted to rely on funding sources from foreign affiliates and offices to meet their liquidity needs. As we argue above, IHCs and the U.S. branches of FBOs should have the same ability to rely on liquidity held outside of the United States.
- FBOs should be permitted to hold the cash component of their U.S. liquidity buffers in internal accounts or in accounts at affiliates. The Board has ample supervisory authority to prevent evasion or misuse of those accounts.
- The Board should clarify what criteria must be satisfied in order to hold liquidity offshore, including addressing operational issues such as whether the buffer needs to be earmarked, segregated or otherwise reserved to meet U.S. branch or IHC liquidity needs. The Board should also be sensitive to potential home office supervisory concerns about too rigid a requirement for reserving or segregating liquidity held at the home office.

- (k) Assets Held on Deposit to Meet State Law Asset Pledge or OCC Capital Equivalency Deposit Requirements Should Be Counted as Part of a Branch's Liquidity Buffer

Many states and the OCC impose some form of asset pledge or capital equivalency deposit ("CED") requirement on the U.S. branches of FBOs. For example, a

²⁶⁸ Although there is some additional risk associated with reliance on FX swaps to provide liquidity in a particular currency, the FX markets for major currencies are robust and firms are able to take into account the risks associated with potential dislocations. Even during the height of the 2011 Eurozone banking crisis, European banks could source Euros and exchange them for dollars in the FX swaps market, albeit at higher prices than were generally available.

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federally licensed branch must maintain deposits generally equivalent to 5% of the branch's total third-party liabilities in one or more accounts with unaffiliated banks in the state where the branch is located.²⁶⁹ In New York, a state-licensed branch must maintain an asset pledge in a segregated deposit account with a third-party New York depository institution generally equal to 1% of the branch's total third-party liabilities.²⁷⁰

We recognize that the assets held to satisfy the OCC's CED requirement or state law asset pledge requirements could in some sense be considered "encumbered" and of reduced utility in going concern stress scenarios. However, their encumbrance is a creature of unique bank regulatory and supervisory requirements and therefore should not be viewed as privately pledged or encumbered assets. In addition, the Board notes that the liquidity buffer requirement is at least partially designed with resolution scenarios in mind, and to that extent these assets are available to the branches' primary supervisor in the event of a liquidation, and should therefore be counted as part of an FBO's liquidity buffer. Indeed, if CED or state law asset pledge assets were not included in the FBO's liquidity buffer, the result would be a truly overlapping and redundant U.S. liquidity requirement.

- (1) The Board Should Clarify that the Liquidity Buffer Will Be Available for Use during Periods of Funding Stress

The final rule should align with the revised Basel III LCR, which affirms that firms should be able to use their liquidity buffers in "a situation of financial stress" and provides guidelines for how banking regulators should evaluate a firm's use of its liquidity buffer. The liquidity buffer should be available for use without prior notice or approval from banking regulators in order to permit banking organizations to respond quickly to sources of stress, although a requirement for prompt after-the-fact notice would be appropriate. In this regard, we support the Board's decision not to include specific liquidity buffer triggers in the proposed early remediation regime because of the risk of causing a procyclical run on liquidity. For similar reasons, we suggest that the U.S. branches of FBOs under "level 2" early remediation should not be automatically required to hold 100% of their liquidity buffer in the United States, which could aggravate liquidity issues at a stressed institution.

²⁶⁹ See 12 C.F.R. § 28.15 and 12 U.S.C. § 3012(g).

²⁷⁰ See NY Comp. Codes R. & Regs., tit. 3, §§ 51.2, 322.1. Branches of "well rated" FBOs have reduced asset pledge requirements under New York law, with a maximum pledge of \$100 million.

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IV. Single-Counterparty Credit Limits

A. General

In our view, the Board's approach in the Proposal to adapting the Section 165 SCCL to FBOs fails to adhere to the specific statutory language of Section 165(e) and fails to heed Congress' statutory mandates to take into account comparable home country standards, comply with the principle of national treatment and competitive equality and tailor the Section 165 Standards based on the systemic footprint of the relevant FBO.

We have especially serious concerns regarding the way the SCCL would be applied to IHCs, since the wording of Section 165(e) is clear that the SCCL requirement for FBOs is to be measured based on the capital and surplus of the FBO parent. Consequently, application of a siloed and sub-consolidated SCCL to an IHC would be inconsistent with the plain meaning of the statute, in addition to presenting compounded challenges and complications for FBOs.

We also have significant concerns regarding the way in which the Proposal would apply a separate SCCL to FBOs themselves, primarily because the SCCL would apply categorically as a U.S.-specific requirement to all FBOs with \$50 billion or more in global assets, regardless of the size of their U.S. operations or systemic footprint.

Beyond the many concerns we have related to the scope of application and basic structure of the SCCL as applied to IHCs and FBOs, we also have several comments regarding the way the Board has proposed to adapt the SCCL to FBOs' cross-border banking operations, including restrictions on inter-affiliate hedging and netting that in our view would be inconsistent with prudent risk management.

B. Application of the SCCL to IHCs Would Contravene Section 165

1. *Specific Statutory Reference to Parent Company Capital and Surplus*

The SCCL component of the Section 165 Standards is informed not only by the statutory requirements discussed throughout this letter (national treatment and competitive equality, comparable home country standards, tailoring, etc.), but also by specific wording in Section 165(e) that requires the Board to analyze the SCCL at the FBO parent level. Section 165(e)(2) of the Dodd-Frank Act prohibits "each ... bank holding company described in subsection (a) [*i.e.*, as interpreted by the Board, each FBO parent that has total consolidated assets of \$50 billion or greater] from having credit exposure to any unaffiliated company that exceeds 25 percent of the capital stock and surplus . . . of the company" (emphasis added). Especially in view of the Board's position that it is constrained to apply the \$50 billion asset threshold for Section 165 based on the global consolidated assets of the parent FBO, Section 165(e)(2) is clear that the SCCL is meant to be analyzed based on the parent FBO's capital and surplus. As a result, the Board lacks authority under Section 165 to apply the SCCL

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to an IHC based on the capital stock and surplus of the IHC (i.e., because the IHC is not “the company” referred to in Section 165(e)(2)).²⁷¹

2. *Mandate to Take Into Consideration Comparable Home Country Standards*

Even beyond this specific statutory infirmity, application of the SCCL to an IHC would also contravene the general standards for adapting the Section 165 Standards to FBOs. Most notably, the Proposal contains virtually no discussion of the existence of home country standards that apply to FBOs on a consolidated basis. Indeed, it is striking that the principal innovation of the SCCL as it relates to U.S. BHCs is the application of a credit exposure limit at the parent company consolidated level (in contrast to solely applying, under different statutes, at the level of a U.S. BHC’s subsidiary banks). In most countries outside the United States, however, credit exposure limits already apply at the level of the parent (usually because the parent is itself a bank).²⁷²

Credit exposure limits have long been a core component of banking regulation in jurisdictions worldwide, and virtually every FBO is subject to some form of home country credit exposure limits.²⁷³ Indeed, international regulators have previously agreed on consolidated credit limits that are similar to those required under the Domestic Proposal. Under the Basel Committee’s Core Principles for Effective Banking Supervision, Principle 19 requires nations to

²⁷¹ We recognize that some IHCs may be U.S. BHCs with \$50 billion or more in consolidated assets at the IHC level. Putting aside our arguments for why the IHC requirement itself is inappropriate and why application of the Section 165 Standards at the IHC level is inappropriate as a general matter (see Parts I and II above), justifying the SCCL under Section 165(e)(2) on the basis of the BHC status of an IHC would—at a minimum—require raising the threshold for its application from \$10 billion in consolidated assets of the IHC to \$50 billion in consolidated assets of the IHC and would require limiting its application to IHCs that owned or controlled a bank subsidiary, making them U.S. BHCs. In addition, our policy arguments below would continue to apply to any application of an SCCL to a subset of an FBO’s global operations and to the way the methodologies are proposed to operate.

²⁷² The Board also notes that U.S. lending limits did not previously capture credit exposures through transactions such as certain derivatives, which Congress addressed not only through the SCCL but also through revisions to applicable lending limits for subsidiary banks. See Dodd-Frank §§ 610 and 611.

²⁷³ See, e.g., the following with regard to countries around the world: European Union (see Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 (on the capital adequacy of investment firms and credit institutions (recast)) (OJ L 177/201, June 30, 2006), Art. 28 (“CRD”); Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 (amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management) (OJ L 302/97, Nov. 17, 2009) (“CRD II”), Art. 2; and Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, COM (2011) 452 (July 20, 2011) (“CRR”), Art. 384); United Kingdom (see Prudential Regulation Authority, Prudential Sourcebook for Banks, Building Societies and Investment Firms: Large Exposures Requirements (PRA BIPRU 10) (April 2013)); Australia (see Prudential Standard APS 221 (updated January 2013)); China (see IMF, Peoples Republic of China: Detailed Assessment Report: Basel Core Principles for Effective Banking Supervision, IMF Country Report No. 12/78 (April 2012), determining that China’s large exposure limits are largely compliant with international accords); Japan (see IMF, Japan: Financial Sector Stability Assessment Update, IMF Country Report No. 12/210 (Aug. 2012), noting that review by Japanese authorities of Japan’s large exposure regime is underway).

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have effective large exposure limits and monitoring.²⁷⁴ The Basel Core Principles stated further that, “[i]n respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following . . . twenty-five per cent of a bank’s capital is the limit for an individual large exposure to a private sector nonbank counterparty or a group of connected counterparties.”²⁷⁵ Indeed, the Basel Committee’s recent Consultative Document on a proposed “Supervisory Framework for Measuring and Controlling Large Exposures” affirms the sustained international commitment to consistent and enhanced regulation of large exposures.²⁷⁶ And in the meantime, individual national large exposure rules evidence significant comparability to the SCCL requirement in the Dodd–Frank Act.

Comparability is further enhanced when viewed from the perspective of the predominant non-U.S. structure for banking—the “universal bank.” Unlike the United States, where a consolidated credit exposure limit for the entirety of a BHC is, as noted above, a new concept adopted in Dodd-Frank, the large exposure limits of other nations have consistently applied to the parent FBO (which is the most internationally active entity) on a consolidated basis. Indeed, notwithstanding the fact that nonbank subsidiaries of U.S. BHCs have not previously had their credit exposures aggregated with their affiliates as a regulatory requirement, the U.S. nonbank subsidiaries of FBOs have already been operating under consolidated large exposure limits for years.²⁷⁷

Especially in view of the prevalence of credit exposure regimes around the world, and the already existing application of those home country rules to all of the U.S. operations as consolidated into the parent FBO, the Board should begin with an assessment of those regimes before contemplating applying a U.S.-specific SCCL to an IHC subsidiary of an FBO. To ignore the existence of such regimes, and how they already apply to the U.S. operations, would be inconsistent with the clear statutory direction in Section 165.

3. *National Treatment and Equality of Competitive Opportunity*

We highlighted the IHC SCCL’s inconsistency with the principle of national treatment and competitive equality in Part I.A.5.e above. Application of the SCCL to an IHC is another area where, in our view, the Board posits the wrong implicit comparison for measuring

²⁷⁴ See Basel Committee, Core Principles for Effective Banking Supervision (Sept. 2012) (the “Basel Core Principles”).

²⁷⁵ Basel Core Principles at 51.

²⁷⁶ See Basel Large Exposure Consultation. The Basel Committee has asked for comment by June 28, 2013. While we do not in this letter comment on or address the appropriateness of the recommendations made in the Basel Large Exposure Consultation, we view the Basel Large Exposure Consultation as a vehicle for developing consistency and visibility into large exposures across jurisdictions, thus further making unnecessary a set of U.S.-centric exposure limits for a subset of an FBO’s operations. Furthermore, the proposals and recommendations in the Basel Large Exposure Consultation are material, and sufficiently different from those in the Proposal such that any Board implementation of its proposals and recommendations would require a notice of proposed rulemaking by the Board for public comment.

²⁷⁷ Even without the universal bank structure, the predominant form of entry into the U.S. by FBOs is through their lead bank and subsidiaries of the lead bank. Such banks are subject to home country large exposure limits. Therefore, the U.S. operations, including the U.S. subsidiaries, are generally already subject to a consolidated large exposure regime even if the lead bank is a subsidiary of a top-tier holding company.

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national treatment. Even using the Board's comparison, however, we believe the analysis results in a national treatment violation.

The Board characterizes the proposed SCCL as “generally consistent” or “consistent” with the Domestic Proposal. Although the methodology for calculating credit exposure is generally similar to the Domestic Proposal, this similarity in calculation methodology does not address the fundamentally different structural application of the SCCL to FBOs relative to its application to U.S. BHCs. The application to FBOs is decidedly not consistent, particularly in ways that are meaningful to the question of national treatment and competitive equality. In our view, these differences would cause significant competitive harm to both the U.S. operations of an FBO and to the FBO itself, and are therefore inconsistent with the statutory requirement that the Board adhere to the U.S. policy of national treatment and equality of competitive opportunity.

First, the Proposal's SCCL is both inconsistent on its face as it would be applied, and inconsistent in effect after it is applied, when compared to the SCCL applicable to U.S. BHCs. In accordance with Section 165(e)(2), the Domestic Proposal would apply the SCCL to large U.S. BHCs on a consolidated basis, and would limit exposure relative to the “capital stock and surplus . . . of the company” (emphasis added), *i.e.*, the top-tier BHC. Under the Proposal, in contrast, the SCCL would apply to an IHC (which may or may not be a BHC, and is certainly not the “company” that is the foreign-based BHC subject to Section 165(e)) and limit its aggregate exposures relative to the IHC's capital and surplus. Applying the Proposal to an IHC notwithstanding this facial inconsistency would also have a disparate and damaging effect on an FBO's U.S. operations. There is no question that an IHC for any FBO will be smaller, by any measure, including capital, than the peer competitors of its FBO parent. Imposing this requirement at the IHC level will hinder the IHC's ability to take on exposures, in both its bank and nonbank subsidiaries, that similarly situated and similarly sized U.S. bank and nonbank subsidiaries of U.S. BHCs would be permitted to take on. In other words, two similarly sized U.S. entities (*e.g.*, broker-dealer, insurance company, etc.) that are subsidiaries of similar (and similarly sized) financial firms would be treated differently merely because of their ownership. This would be discriminatory, would violate national treatment requirements, and would significantly impair the competitive posture of an FBO and its U.S. operations.

Second, even if the Proposal's SCCL requirement for IHCs were evaluated based on the hypothetical assumption that an IHC is the top-tier parent of the organization (which would be a flawed assumption, of course), the SCCL has a more obvious national treatment flaw with respect to the size of the entities to which it applies. Under the Proposal, an FBO is required to create an IHC if the IHC would have \$10 billion or more of assets. Therefore, if the Proposal is implemented, there are expected to be several IHCs with between \$10 billion and \$50 billion of assets. Yet, the SCCL applies to the IHC without regard to its size. Unlike other provisions of the Proposal,²⁷⁸ proposed §§ 252.241(b)(1) and 252.242(a)(1) do not limit the

²⁷⁸ See, *e.g.*, Proposal § 252.212(b) (applying the capital planning requirement of Regulation Y § 225.8 to IHCs with greater than \$50 billion total consolidated assets); Proposal §§ 252.221(b) and 252.231 (applying liquidity buffer requirement to an IHC only if the FBO's combined U.S. assets are \$50 billion or more).

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application of the SCCL to only larger IHCs.²⁷⁹ In contrast, no U.S. BHC that has less than \$50 billion in assets would be subject to an SCCL under the Domestic Proposal. Consequently, again, U.S. entities of similar size and situation would be treated differently because of their foreign ownership structure.

Third, notwithstanding the fact that U.S. BHCs are structured in a variety of ways, and several have intermediate holding companies that may be situated above their bank subsidiaries (and, therefore, would also be “bank holding companies” as defined by the Board²⁸⁰), the Domestic Proposal would not apply the SCCL to intermediate holding companies of a U.S. BHC. As a result, intermediate holding companies of U.S. BHCs generally would be able to have credit exposure to an individual counterparty (and its related entities) based on the capital and surplus of its ultimate parent, the top-tier BHC. FBOs, in contrast, would be required to have an IHC to which the SCCL applies, and compliance with such SCCL would be determined relative to the IHC’s own capital. In order to apply the SCCL to FBOs in a manner similar to that in the Domestic Proposal, the SCCL would need to apply based on the capital and surplus of the FBO regardless of the capital of its IHC and not apply to an IHC even if it is also a parent of a U.S. bank.²⁸¹ Generally, the manner of effecting such application of the SCCL would be to rely on a comparable large exposure limit of the home country as applied based on the capital of the top-tier FBO.

Fourth, FBOs would be subject to a “cross-trigger” provision (proposed § 252.245(c)) that would prevent lending by any of an FBO’s combined U.S. operations, including its U.S. branches, if the IHC’s SCCL to a particular counterparty were breached (and vice versa). Under the Domestic Proposal, a U.S. BHC would not be subject to limits on lending based on the breach of a smaller exposure restriction imposed on only a portion of its operations. For example, the Domestic Proposal does not propose to prevent a U.S. BHC or any of its subsidiaries from increasing the aggregate BHC’s exposure to a counterparty because its bank subsidiary has breached lending limits under the OCC’s Part 32 or the relevant state legal lending limit with regard to that same counterparty.

The discriminatory effects of this cross-trigger feature are exacerbated by the typical operation of an internationally active banking organization. When both U.S. banking organizations and FBOs operate outside their home jurisdiction, it is common for local subsidiary operations to request that the local branch (or even branches outside the local jurisdiction) step in to take on larger exposures when the local subsidiary is approaching its regulatory exposure limit. Presumably, pursuant to the Proposal, this could still be a viable mode

²⁷⁹ We assume that there is an error in Section 252.242(c) of the Proposal. Although this provision is intended to apply the “major” SCCL to an IHC with greater than \$500 billion in assets, as described in Section 252.241(b)(2), it does not contain language that would limit it to only such large IHCs. Unlike its counterpart for FBOs (Section 252.242(b)), the term “U.S. intermediate holding company” is not modified by the word “major” (other than in the title of the subsection), nor does the remainder of the provision limit its application to only IHCs with greater than \$500 billion of total assets.

²⁸⁰ See 12 C.F.R. § 225.2(c)(1). See also 12 C.F.R. § 225.12(d)(3)(i) and its accompanying footnote.

²⁸¹ This point also shows how even the application of the SCCL to an IHC of \$50 billion or more would not be consistent with the statute and would not be consistent with the Board’s method of applying the Domestic Proposal. See footnote 271 above.

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of operation, as the cross-restrictions are not triggered unless the IHC or the combined U.S. operations actually breach the applicable SCCL. However, given the variable nature of exposure under the SCCL (including derivatives and securities financing transactions, the exposure value of which can change daily), the likelihood of an inadvertent breach are greater, and the consequences of a breach would be much more significant for the U.S. operations of an FBO than they would be for all of the operations of a U.S. BHC if its subsidiary bank breached its legal lending limit with regard to a counterparty. Such differential treatment also increases the regulatory monitoring burden on FBOs in a manner not otherwise incurred by U.S. BHCs.

C. The Scope of the SCCL's Application to FBOs Would Contravene Section 165

The SCCL as applied to FBOs in the Proposal would also contravene Section 165, although for different reasons than in the case of application of the SCCL to an IHC. The Proposal's application of the SCCL to FBOs and their combined U.S. operations is more consistent with the explicit direction in Section 165(e)(2) to apply the SCCL based on the capital and surplus of the FBO parent. However, the SCCL as applied to FBOs nonetheless would be inconsistent with the Board's mandate to take into account comparable home country standards and tailor the Section 165 Standards based on an FBO's U.S. systemic footprint.

As in the case of the SCCL as applied to an IHC, the Proposal does not take into account the extent to which an FBO is subject to a comparable home country standard on a consolidated basis. Consequently, for all the reasons described above in Part IV.B.2, the Board has not adhered to the requirements of Section 165 in this respect.

Similarly, because the SCCL would apply to credit exposures of a subset of an FBO's global operations, it is not consistent with the principle embedded in Section 165 of national treatment and competitive equality. Under the Domestic Proposal, for a U.S. BHC, the SCCL would apply to the BHC's total aggregate consolidated exposures, in the way that an FBO's home country large exposure limit would apply to an FBO. Under the Proposal, in addition to the various lending and exposures limits already applicable to FBO operations in the U.S., a separate sub-consolidated SCCL would apply only to the U.S. combined operations. The national treatment flaws with the application of an SCCL to an FBO are mitigated by the fact that the limit would be based on the parent FBO's capital and surplus, but the need to establish separate U.S.-centric systems and controls for the combined U.S. operations of the FBO would nevertheless be inconsistent with national treatment and would diverge from the way the SCCL is applied to a consolidated U.S. BHC. Furthermore, in at least one more specific respect, the SCCL is applied in a discriminatory manner to the U.S. operations of an FBO as compared to the SCCL applicable to U.S. BHCs. Isolating the U.S. branch network from the rest of the FBO legal entity would hinder the U.S. branch network's ability to apply valid and enforceable multi-branch and other netting agreements to reduce the exposure of the U.S. branches. Determining the branch exposure without the effect of offset through such netting agreements will significantly overstate the exposure of the U.S. branch network. Nowhere in the Domestic Proposal is there an inability to net exposures within the same legal entity, and therefore the U.S.

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branch network would be at a significant disadvantage to U.S. BHCs, notwithstanding that the denominator for the SCCL calculation is the FBO's capital stock and surplus.²⁸²

Most acutely, however, the SCCL requirement as applied to FBOs would be seriously overbroad if adopted as proposed. The SCCL requirement would apply to all FBOs regardless of the size or systemic footprint of their U.S. operations. To take an extreme example, an FBO with \$50 billion of assets in its home country but only a \$10 million branch in New York would need to develop the systems to make daily credit exposure calculations under the Board's SCCL methodology designed for major U.S. BHCs, which methodologies do not align with Basel Capital Framework methodologies and likely will not align with home country credit exposure methodologies. Even if the SCCL as a practical matter would not constrain extensions of credit by the branch in this example (*i.e.*, because the size of the denominator will be large in relation to the size of credits extended by the branch), the need to develop U.S.-specific compliance systems for daily exposure calculations would appear completely unnecessary and unjustified by the Board's statutory mandate in Section 165 to protect U.S. financial stability. Indeed, the unlikelihood of any meaningful credit concentration in this example illustrates its lack of connection with protection of U.S. financial stability.

In order to make the SCCL as applied to FBOs more consistent with the Board's mandates under Section 165, the SCCL should (1) first be applied as a U.S. requirement only after a finding that the FBO's home country large exposures regime is not comparable or otherwise consistent with international large exposure standards, and a finding that any such deficiency presents a risk to U.S. financial stability; and (2) at a minimum not apply to any FBO whose U.S. combined operations represent less than \$50 billion in assets. We address more broadly a proposed alternative approach to applying the SCCL to FBOs in Part IV.F. below.

D. As Proposed, the SCCL Would Undercut the Board's Ability to Monitor Risk and Interconnectedness of an FBO

Appropriate home country credit exposure limits, applied on a global, consolidated basis, are the most effective credit exposure tool to address the Board's stated concern about interconnectedness among large U.S. and foreign financial institutions. In contrast, the SCCL requirements in the Proposal would impose redundant and unnecessary credit exposure limits on various parts of an FBO's U.S. operations. Several of these operations are already subject to credit exposure limits. FBOs would be required to comply with: (i) IHC-specific SCCLs based on IHC capital (if applicable); (ii) SCCLs applied to the FBO's combined

²⁸² While we recognize that the Board attempted to address the existence of qualified master netting agreements that cover the entire FBO legal entity (including both onshore and offshore branches and agencies), *see* 77 Fed. Reg. at 76,655-6, it seems as if the Board's solution (although admittedly unclear) was merely to attempt to eliminate exposures of offshore branches (that, helpfully, should not be counted as exposure of the U.S. operations) rather than to actually permit the U.S. branch network's exposure to benefit from netting with offshore transactions. Further, the netting provisions in proposed § 252.244 with regard to securities financing transactions are equally unclear whether netting between onshore and offshore branches of the same FBO legal entity is permissible, or whether the phrase "with respect to its combined U.S. operations" was meant to limit netting only within those operations. The exclusion of the FBO itself and its affiliates from the definition of "eligible protection provider", as discussed below, increases the ambiguity of these provisions.

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U.S. operations (including both branches and IHC) based on global consolidated capital; (iii) federal and/or state lending limits applicable to U.S. bank subsidiaries; (iv) federal and/or state lending limits applicable to U.S. branches and agencies; and (v) home country large exposure limits. In addition, functionally regulated subsidiaries are often subject to different and unique concentration and exposure limits depending upon their business and applicable regulatory framework.

The Proposal layers these various additional exposure limit requirements without sufficient analysis of whether they provide any additional marginal benefit or utility from the perspective of protecting U.S. financial stability. In our view, they do not provide a meaningful marginal benefit, and ironically, they could serve to obscure the Board's view of the risks and interconnectedness of the market.

Locally isolated SCCLs are of limited utility to address interconnectedness among major financial institutions because they ignore exposures that occur outside of the local jurisdiction and do not provide a full picture of aggregate exposure and stresses of the entity or their systemic risk implications. Instead, consolidated concentration limits, accompanied by effective information sharing, offer far more productive mechanisms to monitor and restrict threats to financial stability.

In fact, competitive pressures to participate in large transactions with customers could cause FBOs to rethink the booking strategy for their most credit-worthy and profitable customers. Given the smaller limit on IHCs, the cross-trigger within the Proposal for the combined U.S. operations and the overlap of the proposed two SCCLs and existing lending limits, there are significant incentives for FBOs to move large exposures in loans, derivatives and securities financing transactions to non-U.S. branches that will be subject primarily to a single home country large exposure limit, *i.e.*, a limit that is already being monitored by the FBO. In that scenario, the risk associated with the transaction does not disappear; the interconnection with large customers is not unwound. But the Board's view into that transaction and its ramifications is reduced, notwithstanding the multiple layers of exposure restrictions the Proposal attempts to place on FBOs. A better solution, described further below, is to require FBOs that could have a systemic impact on the U.S. economy (SI-FBOs) to provide reporting of compliance with comparable consolidated large exposure limits imposed by home country regulators. To the extent that the Basel Large Exposure Consultation may lead to standardization of such reporting across jurisdictions, greater benefits and utility would come from employing such tools to gain an understanding of overall risk than from applying a patchwork of sublimits to subsets of an FBO's operations.

E. As Proposed, the SCCLs Would Interfere with the Safety and Soundness and Enterprise-Wide Risk Management of FBOs

Like other components of the Proposal, the SCCL would adversely affect the ability of FBOs to manage the risks of their international operations. Multiple, redundant and inconsistent regimes for calculating credit exposures will needlessly complicate and hinder enterprise-wide risk management and increase the compliance burden on FBOs. Furthermore, other legal and risk management requirements and models provide for calculation of counterparty exposures, such as capital calculation rules, margin calculations rules, restrictions

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on transactions with affiliates, liquidity risk management regimes and collateral management processes, all of which further complicate an FBO's risk management function, especially where the calculation methodologies diverge.²⁸³

In our view, the Proposal fails to take sufficient account of specific implications of the nature of cross-border banking, where a bank can have multiple exposures to a single customer (and its related parties) in multiple countries and currencies, which may be best managed, monitored, hedged and collateralized centrally and in the aggregate through the bank's head office or, for example, a branch with the strongest relationship to that customer or the best ability to hedge in local markets and instruments. In contrast to the Domestic Proposal, where the Board (consistent with the Dodd-Frank Act) focused on requiring U.S. BHCs to centralize, aggregate and monitor their total cross-entity risk, the proposed SCCL would require FBOs to focus on an incomplete picture of their overall risk and their overall operations. This result could not have been intended.²⁸⁴ Incentives to move transactions offshore and the detrimental impact on cross-border, enterprise-wide risk management under the Proposal's application of the SCCLs would run counter to the Board's (and other supervisors') efforts to promote enterprise-wide risk management.²⁸⁵

This lack of consistency increases compliance burdens and distracts from effective risk management. Applying the SCCL to only portions of an FBO's business (even if appropriately measured based on the FBO's consolidated capital and surplus) would result in adoption of duplicative, yet less effective, risk management systems, and increased operational and system costs that could far outweigh any potential financial stability benefits. Diversion of resources and management attention away from refining tested systems designed to manage an FBO's credit risk and towards the development and maintenance of systems with no relevance to

²⁸³ As described below, the proposed SCCL calculation methodology is inconsistent with risk management methodologies utilized for internal risk profiling and for capital risk weighting. In contrast, and as an example, the European Council's directive strengthening its large exposure regime uses internal credit-risk models developed by covered financial institutions and approved by home country regulators in other capital measurement and risk management contexts. See CRD, Art. 106-118 and Annex III; and CRD II, Art. 2. See also Committee of European Banking Supervisors, Technical Advice to the European Commission on the Review of Large Exposures Rules Parts I and II (Nov. 6, 2007 and Mar. 27, 2008) ("CEBS Technical Advice on Large Exposure Limits").

²⁸⁴ In early 2008, even before the peak of the international financial crisis, the Board and other key international bank supervisors had noted that a significant contributing factor to the losses occurring at major financial firms was the inability to centralize, communicate and understand risk across the entire organization. See Senior Supervisors Group, Observations on Risk Management Practices During the Recent Market Turbulence (Mar. 6, 2008) ("Firms that tended to deal more successfully with the ongoing market turmoil through year-end 2007 adopted a comprehensive view of their exposures. . . . [F]irms that performed well . . . generally shared quantitative and qualitative information more effectively across the organization. . . . In contrast, the existence of organizational 'silos' in the structures of some firms appeared to be detrimental to the firms' performance during the turmoil").

²⁸⁵ On one hand, through studies like that of the Senior Supervisors Group, the Board has endorsed greater communication, and cross-entity and aggregate risk management. Yet, in the preamble to the Proposal, the Board describes its "new" belief that centralization can impede the Board's access to information. Without addressing the merits of the Board's view that it does not have timely access to information, we believe that there are more appropriate and flexible ways to harmonize these two goals as discussed throughout this letter.

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the economic or risk profile of the FBO's global operations, and no demonstrated marginal utility, would, in our view, be wholly inappropriate.

F. A Suggested Alternative Method for Applying the SCCL to FBOs

For the foregoing reasons, and in order to achieve greater consistency with the Dodd-Frank statutory conditions on application of the SCCL to FBOs, we would respectfully suggest that the Board implement the Section 165 SCCL requirement for FBOs as follows:

- Similar to the manner in which the Board has proposed to recognize home country standards of capital and stress testing by comparing them to internationally recognized standards, the Board would start with a determination of whether an FBO's home country consolidated large exposure regime is consistent with the Basel Core Principles (or any forthcoming, final international standards based on the Basel Large Exposure Consultation).
- By definition, such standard would be calculated relative to the parent company capital and surplus for the entirety of the organization. No separate SCCL would be applicable to the IHC or the combined U.S. operations, unless the Board determined that (1) the home country large exposure regime was deficient (*i.e.*, not compliant with or comparable to international standards) and (2) failure to apply a special SCCL requirement in a particular case (in contrast to another targeted and/or tailored supervisory technique) would present a risk to U.S. financial stability and application of such requirement would be necessary to mitigate such risk.²⁸⁶
- Of course, U.S. IDIs and U.S. branches and agencies would continue to be subject to existing applicable lending limit rules.²⁸⁷
- The Board would require confirmation from the FBO that it is compliant with all aspects of its home country large exposure rules.
 - In order to ensure that the Board has sufficient information to accomplish the goals of Section 165, FBOs that wish to be exempt from U.S.-specific SCCLs could agree to provide information to the Board regarding their large exposures on a periodic basis.²⁸⁸ The frequency and contents of such reporting requirements would be calibrated based on the systemic importance of the FBO to the U.S. financial system and taking into account home country disclosure, privacy and data protection standards. In this way, the Board could achieve further insight

²⁸⁶ Given the ubiquitous nature of large exposure limits (*see* note 273 above), we would expect that few if any SI-FBOs would fall into this category.

²⁸⁷ As modified and enhanced by the OCC and state regulators pursuant to Sections 610 and 611 of the Dodd-Frank Act.

²⁸⁸ The Basel Core Principles define "large exposures" as those that are above 10% of the regulatory capital of an institution. *See* Basel Core Principles at 51. The Basel Large Exposure Consultation proposes to redefine "large exposures" as those that are at or above 5% of the bank's eligible capital base. *See* Basel Large Exposure Consultation at para. 24.

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into potential risks to the U.S. financial system, without applying unnecessary territorial exposure limits.

- The Board would address any specific concerns related to reported exposures through the supervisory process and in consultation with the FBO's home country supervisor.
- FBOs that legally could not provide or do not provide the Board with appropriate reporting of large exposures could be subject to U.S.-specific SCCLs to the extent necessary to mitigate systemic risks to the U.S. financial system.
- The Board would wait until an international agreement on large exposure limits is reached before applying or calibrating a separate more stringent SCCL for FBO exposure to "major" financial firms.²⁸⁹ Consistency of application of such a limit across jurisdictions will be important to foster competitive equality.

G. To the Extent that the Board Determines to Retain a Categorical U.S. SCCL that Applies to an FBO, Its U.S. Operations and/or Its IHC, the Board Should Revise the SCCL to Mitigate National Treatment, Operational and Risk Management Concerns

If, notwithstanding the concerns and recommendations discussed above, the Board were to retain some form of separate, U.S.-centric SCCL requirement for FBOs, we would have serious reservations about a number of the particulars of the SCCL as proposed. At a minimum, the SCCL would need to be modified to address the following issues, as discussed further below:

- The Board would need to make a specific finding that application of such SCCL(s) is "necessary," as it would diverge from the statutory requirements noted above. In making this determination, the Board would need to take into consideration all other limits that are already applicable to FBOs (including home country credit exposure limits and the U.S. lending limits that apply to the FBO's branches and subsidiary U.S. banks) and find that those are insufficient.
- The Board would need to tailor its SCCL requirements to appropriately address the risk posed by each individual FBO or IHC to U.S. financial stability.
- Several aspects of the SCCL proposal, whether applicable to an IHC or to an FBO's combined U.S. operations, would need to be modified in order to promote competition, safety and soundness and sound risk management principles.

²⁸⁹ Of course, the Board would also be informed about the appropriateness of a "major" SCCL limit by the quantitative impact study that it has indicated it is conducting on this concept.

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1. *The Board Would Need to Make a Specific Finding that Application of the SCCL to Only a Portion of an FBO's Operations Is "Necessary" and that Other Existing Limits Are Not Sufficient*

Because the Dodd-Frank Act authorizes the Board to apply Section 165 concentration limits to a U.S. BHC or FBO based only on consolidated capital and surplus, and because the proposed application of an SCCL to an IHC and separately to the combined U.S. operations of an FBO would not be consistent with several aspects of the statute, to the extent that the Board, notwithstanding these statutory limitations, determines to apply the SCCL to an IHC and/or the combined U.S. operations of an FBO, it may only do so if it determines that the regulations it is promulgating are “necessary to administer and carry out” the application of an SCCL.²⁹⁰ We note that this standard is much more than merely “convenient” or “useful” or “appropriate”; the Board must find that the application of the SCCL in the manner proposed is “necessary” to administer the SCCL to an FBO.²⁹¹

One part of such analysis would be to determine that existing limits applied to FBOs are not sufficient. As noted above, the Proposal could result in no less than 5 different exposure limits applying to FBOs and subsets of their operations, whereas U.S. BHCs would (after finalization of the Domestic Proposal) typically be subject to two. However, prior to the mandate under Section 165(e), U.S. BHCs had not generally been subject to an aggregate exposure limit. In contrast, FBOs and their operations have long been subject to consolidated large exposure limits, primarily because the institution is a bank (like U.S. IDIs), but also because of the “universal bank” structure which typically houses the significant operations of the FBO within the bank in contrast to the predominant U.S. holding company structures. Therefore, we submit that it is not necessary to apply the SCCL to FBOs in the manner proposed in order to effect a consolidated, aggregate exposure limit.

2. *If the SCCL Is to Apply to an IHC, the Board Would Need to More Appropriately Tailor the SCCL Commensurate with the Systemic Risk Posed by the IHC*

In our view, any determination that the proposed SCCL is “necessary” in order to apply the Section 165(e) concentration limits to FBOs must also entail an analysis of the systemic importance of an FBO’s IHC or U.S. operations. Otherwise, home country large exposure limits should be sufficient and recognized as comparable to the Section 165(e) requirement.

The Proposal would apply the SCCL to the combined U.S. operations of any FBO with \$50 billion or more in global assets without regard for the size or systemic importance of

²⁹⁰ Dodd-Frank Act, § 165(e)(5). The application of the SCCL at a lower tier of the organization or for a subset of the organization (e.g., the IHC) could also be deemed a “lower amount” of permitted credit exposure (particularly because of the lower capital base at the IHC than at the top-tier “company” that is the subject of the statutory requirement), in which case the Board is also required to determine such lower amount to be “necessary to mitigate risks to the financial stability of the United States.” Dodd-Frank Act, § 165(e)(2).

²⁹¹ See pages C-14 to C-18 of the Joint Trade Associations Letter for a comprehensive discussion of the meaning of the statutory requirement that rules be “necessary.”

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the FBO's U.S. footprint. As noted above, the Proposal would also apply the SCCL to any IHC, including those between \$10 billion and \$50 billion in total assets.

In our view, it is not necessary to impose the SCCL on every IHC required to be formed under the proposal. Instead, to the extent that the Board were to apply an SCCL to IHCs, the Board should impose the SCCL only on IHCs that could represent a systemic risk to the United States, as determined by an individualized assessment of the IHC's risk profile and the current home country and U.S. regulatory limits on the IHC's (or its parent's consolidated) credit exposures. At a minimum, however, smaller IHCs that do not meet the objective threshold of at least \$50 billion in U.S. assets, should not be subject to separate SCCL requirements.

Similarly, there should be no need to apply separate SCCLs to an FBO's combined U.S. operations because there is no marginal utility or benefit from limiting the combined operations if its IHC (if any) is subject to an SCCL and its U.S. branches and agencies are already subject to state and/or federal lending limits. Such an SCCL will only serve to create overlapping and redundant compliance and operational burdens. We submit that such an SCCL would not be "necessary" for the Board to administer Section 165(e).

If the Board were to apply an SCCL separately to the combined U.S. operations of an FBO, the Board should do so only in extraordinary circumstances where it makes an individualized determination that the combined U.S. operations of the FBO are likely to represent a systemic risk to the United States, taking into consideration the risk profile of the FBO's U.S. operations and the home country and U.S. regulations already applicable to those operations. Although the SCCL for an FBO's combined U.S. operations is unlikely to constrain extensions of credit by an FBO with a small U.S. footprint—because the SCCLs would be calculated based on the FBO's global capital and surplus—the burden of establishing a system for tracking and calculating an FBO's U.S. SCCLs would be significant and should not be imposed on U.S. operations that themselves are not systemically important.²⁹²

Similar to our comments on an IHC SCCL, to the extent the Board were to treat the combined U.S. operations separately from the FBO as a whole (and, thus, separately from the FBO's home country large exposure limits), then, at a minimum, the SCCL should only apply to FBOs with \$50 billion or more in U.S. assets.

²⁹² We note that the FSB currently has designated only 28 G-SIBs pursuant to the Basel Committee's 12-factor approach to assessing systemic importance. See FSB, Update of Group of Global Systemically Important Banks (Nov. 1, 2012). The Board's approach would apply SCCLs to the U.S. operations of nearly four times as many FBOs.

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3. *If the Board Were to Apply the SCCL to an FBO's IHC and/or Its Combined U.S. Operations, Significant Modifications to the SCCL as Proposed Would be Required to Mitigate Harmful, Anticompetitive and Unsound Effects*
 - (a) The Provision Creating a “Cross-Trigger” Between the SCCL for the IHC and the SCCL for the Combined U.S. Operations Should Be Removed

The ability of an FBO's branch to extend credit should not be linked to an affiliated IHC's compliance with its separate SCCL.²⁹³ Such a provision is unprecedented and inconsistent with the manner in which legal lending limits or large exposure limits currently work. Yet, the Board has inserted this cross-trigger feature in proposed § 252.245(c) with no explanation in the preamble to the Proposal and no analytical or evidentiary support for it.²⁹⁴

This provision clashes with the typical operations of internationally active banks, whether they are headquartered in the United States or abroad. Subsidiaries of international banks almost uniformly seek the services of a local (or sometimes “nearby”) branch when the subsidiary would not be able to take on a large exposure, but its parent bank would be. In other words, a “spillover” from the local subsidiary is almost always likely to be picked up by the parent bank, in order to preserve the customer relationship (particularly when the parent bank can provide services that the local subsidiary cannot in order to preserve that relationship). Given the dynamic nature of exposure under the SCCL (which includes derivatives and securities financing transactions, the exposure value of which may change daily), FBO's U.S. operations should not need to manage themselves to undue constraints for fear that the credit operation will be shut down because the IHC has inadvertently or even negligently breached the SCCL with regard to a counterparty.²⁹⁵

Currently, breaches of legal lending limits applicable to a bank subsidiary of a U.S. BHC would not prevent a sister bank, an affiliated broker-dealer or its parent holding company from increasing its exposure to such counterparty. Indeed, one of these entities may specifically increase its exposure in order to avoid losing an opportunity with a credit-worthy and

²⁹³ See Part IV.B.3 above for a discussion of how this provision is discriminatory, will harm the ability of an FBO's operations to compete with similarly sized and situated financial firms and is at odds with the manner in which the SCCL under the Domestic Proposal is being applied to U.S. BHCs.

Furthermore, although we describe in the text the significant harm that could be caused to an FBO's branch network by a cross-trigger based on the IHC's SCCL, we also believe that the IHC should not be subject to a cross-trigger based on the SCCL applicable to the branch network. To the extent that the Board wishes to treat the IHC as separately as possible, then the IHC should be able to utilize its completely separate SCCL based on its own separate capital. If the IHC houses all of the U.S. operations other than the branch network, and has not utilized its limit with respect to a counterparty, it would not seem to cause any additional strain or stress to the IHC to continue using its own limit.

²⁹⁴ See 77 Fed. Reg. at 76,657 (recitation and summary of the proposed regulatory text without explanation).

²⁹⁵ We also note that, if the IHC were compelled to reduce exposures (and potentially allow the branch network to take on such exposures), such exposures are more likely to reduce the earnings power and strength of the IHC's IDI subsidiaries than any other subsidiaries, as the branches are more likely to be able to take on bank-eligible exposures.

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profitable customer. The Domestic Proposal also does not include a provision that would make the U.S. BHC's ability to use the full extent of its SCCL dependent upon its bank subsidiaries' compliance with their separate legal lending limits, and it would be inappropriate to include such a provision.

Even under the SCCL as proposed, and under existing legal lending limits applicable to branches and agencies under federal and/or state law, the limit applicable to the branch operations is keyed off of the FBO's consolidated capital and surplus, and therefore will certainly be larger than that of the IHC. This larger limit is, in fact, the reason why the branch network, in accordance with common business practice, should step in where the IHC may be approaching or may even have breached its limit. The larger limit is also established clearly to not be dependent upon the smaller capital of the IHC, although the cross-trigger provision would, in fact, add such a dependency and contingency. The Board should not, on the one hand, treat an IHC as a separate entity independent from its affiliated U.S. branches while, on the other hand, linking its branches' lending privileges to the IHC's compliance with its separate SCCL.

The cross-trigger also creates significant incentives for FBOs to shift branching, banking, lending and derivatives activities to overseas branches in order to avoid the potential sudden curtailment of activity that could result from the cross-trigger. It could not have been intended for the Board to lose sight and access into the risk-taking operations of an FBO through the use of this provision. The Board also could not have intended to make it more costly for clients to access credit and for FBOs to provide credit, in the face of the limping recovery from the 2007-2009 crisis.

Therefore, the consequences for exceeding an entity's SCCLs should be limited to the entity (or group of entities) in breach, just as the consequences of breaching the lending limits applicable to U.S. bank subsidiaries of FBOs do not extend a restriction to the U.S. branches of FBOs under current lending limit regulations.²⁹⁶

- (b) Without Changes to the Various SCCL Provisions Related to Hedging of Risks, the Ability of an IHC and/or an FBO's Combined U.S. Operations to Mitigate Risk in Their Businesses Will Be Impaired

Like the Domestic Proposal, the proposed SCCL contains several risk mitigation provisions designed to allow an FBO's U.S. operations to reduce its gross credit exposure when calculating compliance with the SCCL. However, the Proposal also contains several provisions

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At a minimum, if the cross-trigger feature were retained, the Board should revise the standard in Section 252.245(c) of the Proposal applicable to case-specific determinations that credit transactions by a U.S. branch should be permitted to continue following a breach by an affiliated IHC of its own, separate SCCL limit. The standard in Section 252.245(c) suggests that such determinations would require a finding that the relevant credit transactions are "necessary or appropriate to preserve the safety and soundness of the [FBO] or U.S. financial stability." In our view, that standard sets an unnecessarily high bar for such determinations in view of the basic unfairness of the cross-trigger feature. If the feature is retained, the standard for such determinations should be revised to permit branch credit transactions to continue as long as the Board determines that such transactions would not create a risk to U.S. financial stability (the core purpose of Section 165).

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unique to the application to FBO U.S. operations that are not found in the Domestic Proposal. Such provisions not only create a disparate and negative competitive impact on the U.S. operations of an FBO, but severely hamper the ability of an FBO's U.S. operations to hedge risks in an efficient and centralized manner.

Eligible Protection Providers²⁹⁷ and Enterprise-Wide Risk Management

The Proposal diverges sharply from credit risk management practices and other systems that both U.S. and non-U.S. banking organizations have developed over many years in close collaboration with their supervisors to foster enterprise-wide risk management. Guarantees, swaps and other derivative transactions between the branches and affiliates of a banking organization are a common method of managing and distributing risk to the geographic locations best suited to hedge those risks. This practice is not unique to FBOs. U.S. banks and BHCs also undertake these risk management activities globally.

However, the Proposal's exclusion of an FBO's home office and its affiliates from the definition of "eligible protection provider"²⁹⁸ would hinder effective enterprise risk management practices, with significant negative concomitant effects on the safety and soundness of an FBO's consolidated operations. For example, an FBO that lends, through its U.S. branch, to a local subsidiary of a customer based in the FBO's home country may be most effectively and efficiently able to hedge credit exposures to that customer in its home country, where the head office will likely have access to a more liquid third-party market for protection on the customer. As another example, an FBO may run its global derivatives trading business out of its head office or out of an international financial hub, such as London, Hong Kong or Singapore. Having the U.S. operations negotiate one-off master agreements with third parties to obtain appropriate hedges would be inefficient and would likely undercut the benefits of netting or other portfolio effects obtained through hedging with the global trading hub.

Relatedly, the Proposal should explicitly recognize the purchase of loan participations (funded or unfunded) by offshore branches or affiliates of the FBO.²⁹⁹ All banking organizations, including U.S. banking organizations, support local operations in their quest to fulfill large customer credit needs by purchasing participations into the parent bank (which likely has greater cash resources and a larger lending limit). In particular, an IHC, with its smaller capital base and limit under the proposed SCCL, would be significantly impaired in its ability to compete with similarly sized local competitors if it could not receive a reduction in its exposure to a counterparty for participations sold to the U.S. or non-U.S. branches and affiliates of the FBO.

The exclusion of head office and non-U.S. affiliates from the definition of "eligible protection provider" is an especially serious flaw and inconsistency in the Proposal's

²⁹⁷ See also Part IV.I.2 below where we suggest that sovereign entities, even if deemed to be affiliated with an FBO, should be permitted to be eligible protection providers for such FBO.

²⁹⁸ See Proposal § 252.240 (definition of "Eligible Protection Provider"). Such an exclusion does not appear in the definition of "eligible protection provider" in the Domestic Proposal.

²⁹⁹ Cf. 12 C.F.R. § 32.2(k)(2)(vi) (explicit recognition of sale of participations in national bank legal lending limit rules).

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approach to the SCCL for FBOs. On the one hand, the general thrust of the Proposal is the creation of a ring-fenced structure designed to separate U.S. operations from their overseas affiliates and enable them to be as capital- and liquidity-independent as possible. On the other hand, the Proposal would not allow such walled off operations to consider offshore affiliates as third party suppliers of protection. Indeed, it is profoundly unclear why an offshore third-party provider of protection should be viewed as more likely to pay its obligations to unrelated U.S. operations during a time of stress than offshore parties that are, in fact, related to the U.S. operations.³⁰⁰ Furthermore, it is also unclear why a rule about the exposure to risk of a third-party counterparty default should be informed by a concern over risks posed by an affiliated party, particularly when that affiliated party is outside of the calculation group for the exposure limit.

In our view, an FBO's U.S. operations, including the IHC, should be able to purchase swaps, guarantees and similar protection from, and sell participations to, offshore affiliates in order to mitigate the exposures that count toward the SCCL. In addition, the U.S. operations, to the extent otherwise legally permissible and enforceable, must be able to take advantage of netting agreements and other similar arrangements involving the FBO's non-U.S. affiliates or branches, particularly for purposes of mitigating the exposure of derivatives and securities financing activities.³⁰¹

Swaps Push-Out Exacerbates this Problem

The Proposal underscores the importance of fixing the treatment of uninsured branches under the so-called "swaps push-out" provisions of Section 716 of Dodd-Frank. Although ambiguous and difficult to decipher logically, Section 716 has been read to mean that an uninsured branch of an FBO that registers with the CFTC as a swaps dealer would not be able to access the discount window unless the uninsured branch "pushed out" its swaps dealing activities. Under Section 716(d), numerous activities are explicitly permitted to "insured depository institutions" (i.e., are not required to be "pushed out" by IDIs). One such permitted activity, described in Section 716(d)(1), is "[h]edging and other similar risk mitigating activities directly related to the IDI's activities."

Unless the Board clarifies this issue soon (e.g., by treating uninsured branches as, or the same as, IDIs for purposes of discount window access), the U.S. branches of an FBO that is a registered swaps dealer could be prohibited by Section 716 from undertaking even hedging

³⁰⁰ Indeed, the Board recognizes that an FBO's U.S. operations may participate with offshore portions of the FBO's business in order to net exposure under a qualified master netting agreement. See 77 Fed. Reg. at 76,655 – 56. We note, however, that these references are not clear as to whether they permit netting of the U.S. branch network with offshore branches. See note 282 above.

³⁰¹ This further illustrates the rationale for applying large exposure limits like the SCCL on a consolidated, top-tier basis. If the Board were to adopt our recommendations in Part IV.F. above, this treatment of interaffiliate transactions would not be required, because the total consolidated exposure would be limited by home country large exposure limits recognized by the Board. Furthermore, our recommendation would create consistency relative to U.S. BHCs which would not be hampered by the SCCL in determining how subsets of their operations may be able to manage risk and comply with limits within their organization (other than potentially for purposes of Section 23A which is an entirely separate regulatory regime).

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and risk mitigating activities, compounding the national treatment concerns regarding both the Board's implementation of Section 716 and the Proposal.

To the extent that the Proposal does not permit FBOs to obtain exposure mitigation through hedges internally with offshore branches and affiliates, an FBO would need to seek such protection externally with third parties. Unless the uninsured branch disparity in Section 716 is remedied, Section 716 could prevent such market activity for an FBO that has registered as a swaps dealer, rendering the uninsured branch unable to reduce its credit exposures through hedging at all.

Custody of Collateral

Under the Proposal, “eligible collateral” is (1) required to have its security interest held by the U.S. IHC or any part of the FBO's combined U.S. operations, and (2) required to be on deposit, if it is cash collateral, with the U.S. IHC or any part of the U.S. operations, the U.S. branch or the U.S. agency.³⁰² The Proposal's artificial line separating an FBO's U.S. and non-U.S. operations with regard to collateral management would interfere with effective enterprise-wide risk management.

Many U.S. and global financial institutions manage their counterparty exposures on a global consolidated basis, with centralized collateral management and global master netting agreements. For example, under a global master netting agreement with a multi-branch credit support annex, one non-U.S. branch of an FBO may hold all the collateral pledged by the counterparty, even though multiple branches of the FBO (including the U.S. branch) interact with that counterparty. The branches rely on both internal netting across branches of the same FBO legal entity and the collateral held by one or more branches of the same FBO legal entity. The FBO should be permitted to take into account collateral held at the non-U.S. branch for the benefit of its U.S. branch.³⁰³

In addition, if the client has consented to the security interest, and the security interest is otherwise perfected under applicable law, it also should not matter that collateral is held in custody or on deposit by a separate non-U.S. affiliate of the U.S. operations for the benefit of the U.S. operations. Therefore, such collateral should also be recognized as a valid mitigant to exposure held in the U.S. operations.

In this specific respect, the Proposal discriminates against FBOs and their U.S. operations. The proposal would violate the core principle of national treatment and competitive equality to the extent it prohibits FBOs from counting such collateral, when U.S. BHCs are permitted to count collateral, hedges, netting agreements and other arrangements from any part of their global operations—even if maintained in a foreign jurisdiction under foreign law in an entity subject to regulation by a foreign regulator. If neither (1) the fact that perfection of a security interest is accomplished by a separate entity, under foreign law, subject to regulation by

³⁰² See Proposal § 252.240 (definition of “Eligible Collateral”). Such requirements do not appear in the definition of “eligible collateral” in the Domestic Proposal.

³⁰³ In a separate part of the proposed SCCL, the Board recognizes that international banks operate routinely in this fashion, although the effect of that recognition is unclear. See 77 Fed. Reg. at 76,655 – 56.

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a foreign regulator, nor (2) the placing of cash collateral on deposit at an affiliated non-U.S. bank, presents a U.S. financial stability concern to the Board with regard to U.S. BHCs, it should not be a concern with regard to the U.S. operations of FBOs, as there is no practical difference.

This disparity should be solved by allowing FBOs to hold collateral and other hedges outside of the United States. By penalizing FBOs that keep collateral and maintain hedges outside of the United States, the proposed SCCLs would push FBOs to maintain collateral and hedges locally or to move credit exposures offshore, even if the collateral, hedges and/or credit exposures are more effectively and efficiently managed in another location or managed jointly.

*Eligible Collateral*³⁰⁴

Pursuant to the Proposal, “eligible collateral” excludes “any debt or equity securities (including convertible bonds), issued by an affiliate of the U.S. [IHC] or by any part of the combined U.S. operations.”³⁰⁵ Such a requirement does not appear in the definition of “eligible collateral” under the Domestic Proposal. Thus, a U.S. BHC subject to Section 165 is permitted to take collateral in the form of securities issued by it or any of its subsidiaries. This divergence by itself should be sufficient to require elimination of the restriction on eligible collateral.

Moreover, this is yet another example of the inconsistencies in the Proposal derived from the artificial separation imposed by the Board on an FBO’s U.S. operations. The Proposal would act to enforce as much independence of the IHC and U.S. operations of an FBO as possible, yet it would not allow the U.S. operations to build on that separateness by considering its offshore affiliates to be the equivalent of arm’s-length third parties. Section 165(e) specifically concerns exposure to “unaffiliated” counterparties. There is no evidence that Congress intended Section 165(e) to be an implicit analog to Section 23A of the Federal Reserve Act (which would generally make affiliate securities ineligible as collateral posted to a bank for purposes of complying with Section 23A’s restrictions). Section 165(e) does not include within its mandate the goal of limiting the U.S. operations’ exposure to its offshore affiliates. Section 165(e) is solely about limiting exposure and risk to third parties. If the collateral otherwise meets the definition of eligible collateral, then its value should serve to offset the exposure to a customer or counterparty. Ability to monetize collateral in the case of a counterparty default should not normally be affected by the fact that the collateral is in the form of securities issued by that entity or one of its affiliates.

H. The Application of a Separate, More Restrictive SCCL for Exposures to “Major” Counterparties Would Have a Significant Negative Impact on Liquidity Risk Management

Pursuant to the liquidity buffer provisions, depending on how the Board resolves some of the issues discussed in Part III, an IHC or a U.S. branch or agency network may need to

³⁰⁴ See also Part IV.I.2 below where we request that the debt or equity securities of sovereign entities, even if deemed to be affiliated with an FBO, should be permitted to be eligible collateral for such FBO.

³⁰⁵ See Proposal § 252.240 (definition of “Eligible Collateral”).

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place cash deposits at unaffiliated institutions. Proposed § 252.227(f)(1) would require an IHC to hold cash assets for its liquidity buffer within the United States, provided that such cash may not be held on deposit with the U.S. branch, or other affiliate, of the FBO. Proposed § 252.227(f)(2) would require a U.S. branch or agency network of an FBO to hold cash assets for its liquidity buffer within the United States, provided that such cash may not be held on deposit at the IHC or other affiliate. Under proposed § 252.240, a “credit transaction” that must be included in a firm’s gross exposures under the SCCL includes “deposits.”

If the net effect of these provisions were to require affirmatively that both an FBO’s branches and agencies and its IHC hold the required liquidity buffer at unrelated third parties,³⁰⁶ application of a lower SCCL requirement for major firms could have a punitive effect when combined with the liquidity buffer provisions. “Major” firms are most likely to have the infrastructure and services to support another major firm’s cash deposit and cash management needs. As a result, an FBO’s “major” firm SCCL could be significantly depleted for certain major counterparties merely by virtue of cash liquidity deposits. This issue is unique to the application of the SCCL to FBOs and does not seem to serve as a constraint on U.S. BHCs subject to the SCCL because U.S. BHCs are not forced to hold liquidity away from their own organization.

We understand that the Board is undertaking a quantitative impact study on this “major” SCCL, although the Proposal implies that the percentage for the limit is the principal or only issue in question. We fully support the comments on the “major” SCCL submitted in the Joint Trade Associations Letter in relation to the “major” SCCL in the Domestic Proposal. Although the significant decrease from 25% (in the primary SCCL and in Section 165(e)(2)) to 10% was one aspect of the industry’s objection to the “major” SCCL, there were other facets to such objections that have not yet been addressed, and no mention was made of them in relation to the Proposal. We wish to add to these objections the potentially harmful interplay for an FBO between the “major” SCCL and the liquidity provisions of the Proposal.³⁰⁷

³⁰⁶ See Part III.B.3.h above for our understanding that this liquidity buffer for the IHC is meant to be a consolidated IHC buffer, and our suggestion that the Board permit an IHC to hold its liquidity buffer at affiliated U.S. branches (and vice versa).

³⁰⁷ We note that there are already other disincentives to one financial firm transacting business with other financial firms, and it should not be “necessary” (a determination that is required pursuant to Section 165(e)(2) in order for the Board to apply a lower SCCL) to layer on a significantly lower limit for such exposures. See, e.g., Basel III at para. 102, and Board et al., Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule, 77 Fed. Reg. 52,978 (Aug. 30, 2012) (“Advanced Approaches NPR”) at 52,984 (applying a 1.25 risk weight multiplier to the exposures of a large banking organization to another financial company); Basel III at paras. 80 – 86, and Board et al., Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012) (“Basel III NPR”) at 52,862 (requiring deduction from Common Equity Tier 1 capital of various investments (synthetic or cash) in unconsolidated financial companies); Board et al., Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564 (May 11, 2011) and Basel Committee/International Organization of Securities Commissions, Second Consultative Document: Margin requirements for non-centrally cleared derivatives, (Feb. 2013) (given end-user exemptions, margin requirements largely affect the inter-dealer/financial firm swap market); Sections 610 and 611 of the Dodd-Frank Act, as well as OCC implementation (OCC, Lending Limits, 77 Fed. Reg. 37,265 (June 21, 2012) (“OCC Lending Limit Revisions”)) and state implementation (see, e.g., New York (3 N.Y.C.R.R. tit. 3, §

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Overall, we would also respectfully urge the Board to wait for an international agreement to be reached, and international implementation to begin, on consistent large exposure standards before applying and calibrating a separate, more stringent SCCL for “major” firms under U.S. law. Because its primary effect is international in scope, it is crucial to harmonize and coordinate efforts on a provision of such magnitude, so as to avoid significant negative effects on cross-border competition and international liquidity.

I. Other Significant Issues with the SCCL

1. *The Breadth of the Sovereign Exposure Exemptions Should be Expanded*

As we argued in the context of the Domestic Proposal, the final rule should extend the exemption from the calculation of credit exposures for U.S. government and agency obligations to include not just obligations of the FBO’s home country, but also other high quality sovereign obligations.³⁰⁸ Subjecting these obligations to the SCCL would have harmful and disruptive effects on the markets for these securities, and would needlessly and harmfully curtail many appropriate banking activities, such as the use of non-U.S. government securities by U.S. and non-U.S. institutions in repurchase transactions for liquidity, in foreign exchange risk management and for other customary treasury activities.³⁰⁹ We further note that the large exposure limits of a number of other countries exempt high quality sovereign securities other than those of the home country.³¹⁰

Beyond limiting the direct use of sovereign obligations in treasury, risk management, liquidity, reserves and investment activities, subjecting sovereign obligations to the SCCL would also negatively affect the acceptance of such obligations as collateral for many types of transactions globally. In many jurisdictions, as in the United States, local sovereign debt securities constitute the primary type of collateral used in secured transactions. Further, high quality sovereign debt is used extensively as collateral in international derivative, repurchase and securities lending transactions. Because both the Proposal and the Domestic Proposal would decrease the liquidity of sovereign debt markets through limits on ownership of such securities, such securities would become less acceptable as collateral. Furthermore, the Proposal and the Domestic Proposal also directly affect their use as collateral by potentially causing covered companies either (1) to request the posting of exemptive collateral (currently defined to include only U.S. government obligations and an FBO’s home country obligations) or (2) to reject sovereign debt securities (for which a covered company may be approaching its limit) as

117 (Lending Limits: Inclusion of Credit Exposures Arising from Derivative Transactions), adopted Jan. 18, 2013 (“[NY Lending Limit Revisions](#)”)) (adding derivative counterparty exposure and securities financing exposure to legal lending limits will have disproportionate effect on interdealer/financial market relative to end-user/customer market).

³⁰⁸ The Basel Large Exposure Consultation ([see](#) paras. 9, 97 – 98) has deferred consideration of the treatment of exposures to sovereigns and their “connected” entities.

³⁰⁹ For a more detailed discussion of many of the vital economic roles of non-U.S. government securities, [see](#) Part V of our comment letter, dated February 13, 2012, regarding the proposed Volcker Rule.

³¹⁰ [See, e.g.](#), CRD II, Art. 24 (amending Article 113 of the CRD to exempt sovereign exposures); CEBS Technical Advice on Large Exposure Limits, Part II, p. 29; PRA: BIPRU 10.6.34 – 37 (Apr. 1, 2013).

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collateral in favor of other collateral to which a covered company can more easily “shift” its exposure under the discretionary “shift” permitted by the Proposal and Domestic Proposal. The impact is especially acute for both U.S. and non-U.S. financial institutions that have international operations, as they are the most likely to be forced to disrupt customer relationships by requiring customers to post only U.S. or one single home country’s sovereign securities rather than their customers’ home country sovereign securities.

Such reactions by covered companies would have a disproportionate impact on FBOs as they are, and historically have been, the primary users of sovereign collateral in their dealings with counterparties, including U.S. covered companies. Furthermore, FBOs are often major market-makers for these securities and play a central role in extending credit to sovereign entities both inside and outside of their home jurisdiction.

We therefore fully support the recommendations in the Joint Trade Associations Letter that sovereign debt securities, including outside an FBO’s home country, be excluded from the SCCL and not be subject to haircuts in relation to repurchase, securities lending or other transactions where they are used as collateral. Subject to certain recommendations below regarding host country securities, we also agree with the suggested limitation of this exception to those “high quality” sovereign obligations defined in the Joint Trade Associations Letter. Because the Board included sovereign entities as counterparties on its own initiative,³¹¹ it should have the appropriate legal authority and discretion to tailor these exemptions.

If a broader exemption is not adopted, at a minimum, high-quality sovereign debt and “major host country” sovereign debt should be exempted. These should include:

- For a tiered FBO, the sovereign debt obligations of every home country for a bank in the FBO’s structure.
- Sovereign debt securities that are assigned a specific risk-weighting factor of 1.6 or less under the market-risk capital rules, or securities issued or guaranteed by the government of an OECD full-member country or that has concluded special lending arrangements with the IMF.
- Sovereign debt of host countries that would not otherwise meet the criteria above, where the FBO derives at least 5-10% of its annual gross revenue.

We also note that concerns about the failure to exempt high quality foreign sovereign exposures from the SCCL are exacerbated by the aggregation methodology employed by the Proposed Rule. We would urge the Board not to aggregate political subdivisions or entities that have their own source of revenue for repayment of obligations and for which the sovereign is not responsible. This could be accomplished through the application of a “means and purpose” test (like that employed in the national bank lending limits) or other similar

³¹¹ Compare Section 165(e)(2) (restricting credit exposures to unaffiliated companies) with Domestic Proposal, 77 Fed. Reg. at 613 and Proposal, 77 Fed. Reg. at 76,654 (discussing the Board’s proposed inclusion of foreign sovereigns in the definition of “counterparty”).

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methodology to determine whether political subdivisions of a sovereign government should be aggregated with that sovereign.³¹²

Additionally, securities of development banks and similar multilateral and multinational organizations should be exempt. The Board has already determined that such securities would receive a 0% risk weight for the purpose of the capital rules.³¹³

2. *Institutions Controlled by a Sovereign Should not be Deemed Part of the Sovereign for the Determination of Compliance with Limits on Exposure to the Sovereign*

The Proposal's and the Domestic Proposal's potential aggregation of state-controlled non-U.S. banks and bank holding companies with their home country sovereigns for purposes of the SCCL is inappropriate. Sovereign credit risk can diverge significantly from the credit risk of entities controlled by that sovereign. The products and activities of banking organizations provide resources and sources of income separate from the sovereign. Indeed, the recovery underway in the financial system today highlights this divergence; financially stable governments hold equity positions in both robust and challenged financial institutions, while healthy organizations are generally in the process of repaying government assistance and emerging from controlling ownership by revenue-stressed governments. The exposure to an FBO has a wholly different purpose and risk profile from exposures incurred in relationships with sovereigns. For these reasons, the Board should not deem such banking organizations to be aggregated with the sovereign state.

In addition, a determination to aggregate a state-controlled banking organization with its home country sovereign would serve to eliminate, or at least significantly weaken, an essential stabilizing tool used by many countries in the most recent crisis. Aggregation with the sovereign could impede the orderly resolution of troubled institutions if extraordinary assistance or similar government intervention forces covered companies to reduce their credit exposures to the troubled institution to come into compliance with the SCCL under the Proposal and the Domestic Proposal. This effect would cut off liquidity to the institution in a time of stress, put significant downward price pressure on the debt obligations of the troubled institution and could increase the difficulty of restructuring the institution outside of an insolvency (or in a creditor-supported insolvency). Many of these effects are likely to precede any actual government intervention—the anticipation of that intervention could become a self-fulfilling expectation as it creates a “run” on the institution in the wholesale markets. Furthermore, the proposed approach would severely constrain the ability of a government to establish a bridge bank to resolve a troubled FBO, because the bridge bank, as a subsidiary of the sovereign, would find that many counterparties could not engage in business with it.

For the foregoing reasons, we strongly urge the Board to appropriately circumscribe the scope of exposures that are aggregated in the determination of credit exposure

³¹² See, e.g., 12 C.F.R. Part 32.5(f).

³¹³ See Board et al., Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888, 52,896 (Aug. 30, 2012); Board et al., Risk-Based Capital Guidelines: Market Risk, 77 Fed. Reg. 53,060, 53,107 (Aug. 30, 2012)

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to a sovereign under the final rule by excluding foreign banking entities and other financial companies.

As a related point, we note that “eligible protection providers” under the Proposal would include “sovereign entities” as defined in the Proposal. To the extent that the Board determines that an FBO is “affiliated” with sovereign entities because of the sovereign’s degree of ownership in, or support to, an FBO, we also respectfully request that such FBOs and their IHCs continue to be able to use home country “sovereign entities” as eligible protection providers. Governments around the world utilize export-import banks, central banks, sovereign development funds and similar entities to provide guarantees, letters of credit or additional support for international trade and monetary flows and domestic and international policy initiatives. Therefore, notwithstanding the provision in the Proposal that an eligible protection provider would not include “the foreign banking organization or an affiliate thereof”, we believe that the independent policy initiatives forwarded by sovereigns through various sovereign entities should be sufficient to allow such an FBO to continue to treat its home country sovereign and other sovereign entities as eligible protection providers. For the same reasons, debt and equity securities of the home country sovereign or sovereign entities should not be deemed ineligible collateral for such FBO or its IHC, notwithstanding the provision in the definition of eligible collateral that would exclude “debt or equity securities (including convertible bonds), issued by an affiliate” of the FBO or IHC.

3. *Compliance with the SCCL on a Daily Basis is Burdensome and Inefficient*

The Domestic Proposal would reinforce common regulatory guidance to aggregate a BHC’s understanding of risk across its businesses, entities and geographies. In contrast, the Proposal would carve up an FBO’s risk aggregation function by imposing multiple additional layers of exposure limits at levels below the top-tier. The proposed SCCL would thus require slicing and apportioning aggregated data in order to provide a more limited picture of certain businesses, certain entities and certain geographies. Such an exercise is operationally burdensome, different from the exercise to be performed by U.S. BHCs, and contrary to the direction (centralization and aggregation of risk management) in which regulators have been pushing the financial industry.

Furthermore, we note that the calculation methodologies under the SCCL are not consistent with those applicable to state and federal branches of an FBO.³¹⁴

Therefore, the Proposal’s requirement for daily calculation and certification of compliance pursuant to proposed § 252.245(a) would be extremely operationally intensive, contrary to the systems already focused on aggregation of data or on the lending limits of branches, and costly to implement. As we argued above, only IHCs and U.S. operations that are systemically important should have to apply the SCCL. If the Board determines to apply the

³¹⁴ See 12 U.S.C. § 3105(h)(2) and (3) (subjecting state branches and agencies to the same single borrower lending limits applicable to Federal branches and agencies, unless state rules are more stringent); OCC Lending Limit Revisions (proposing 3 different options, including internal model methodology, for determining counterparty credit risk under derivatives, none of which is the same as the Board’s proposal to use the Current Exposure Methodology).

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SCCL more broadly, then the requirement for daily compliance should be removed and substituted with a quarterly compliance requirement similar to that for IDIs.

4. *There Would Be No Basis for Applying the SCCL based on an FBO's Common Equity*

In the Proposal, the Board asks whether the definition of “capital stock and surplus” might focus on common equity.”³¹⁵

Congress used the term “capital stock and surplus” in Section 165(e)(2) of the Dodd-Frank Act knowing the existence of its definitions in similar contexts, such as Section 23A of the FRA and the OCC legal lending limit rules,³¹⁶ and knowing that such definitions were broader than common equity alone.³¹⁷ Therefore, the Board would lack statutory authority to determine that the SCCL percentage limit should be based on anything other than the “capital

³¹⁵ 77 Fed. Reg. at 76,655.

³¹⁶ See 12 U.S.C. § 371c(a)(1) (basing Section 23A limitations on the “capital stock and surplus” of the member bank); 12 C.F.R. § 223.3(d) (definition of “capital stock and surplus” for purposes of bank exposure limits to affiliates under Board’s Regulation W); 12 U.S.C. § 84(a) (using “unimpaired capital and unimpaired surplus” as the base for national bank lending limits); 12 C.F.R. § 32.2(c) (definition of “capital and surplus” for purposes of national bank lending limits). See also 12 U.S.C. § 84(c) (basing a number of exceptions to the national bank lending limits on the “capital and surplus” of the bank).

³¹⁷ As further evidence of congressional and federal regulator use of this and similar terms in relation to investment and exposure limits, see, e.g., 12 U.S.C. § 24(Seventh) (limitation on national bank investment securities based on “capital stock actually paid in and unimpaired” and “unimpaired surplus fund”); 12 C.F.R. § 1.2(a) (defining “capital and surplus” for purposes of investment securities limits); 12 U.S.C. § 282 (national banks required to purchase stock of Federal Reserve Banks equal to 6% of “capital stock and surplus” of national bank); 12 U.S.C. § 287 (same for all member banks); 12 U.S.C. § 371d (limitation on investment in bank premises based on “capital and surplus” of the bank); 12 U.S.C. § 372 (limitations on amount of bankers’ acceptances based upon “paid up and unimpaired capital stock and surplus”); 12 U.S.C. § 373 (same for international bankers’ acceptances); 12 U.S.C. § 463 (limitation on deposit balances with institutions having no access to discount window based on “paid-up capital and surplus”); 12 U.S.C. § 601 (limitations on investing in entities principally engaged in international or foreign banking based on “paid-in capital stock and surplus”); 12 U.S.C. § 618 (limitations on investment in Edge or Agreement corporations based on “capital and surplus” of bank); 12 C.F.R. §§ 211.2(c) and 211.5(h)(1) (defining “capital and surplus” for purposes of Regulation K, and basing limits on investments in Edge corporations on “capital and surplus”); 12 U.S.C. § 615(c) (limitation on investments by Edge and Agreement corporations based on “capital and surplus”); 12 U.S.C. § 1464(u) (federal savings associations apply national bank lending limits and certain special limits for savings associations based on “unimpaired capital and unimpaired surplus” of the savings association); 12 U.S.C. § 1757(5)(A)(x) (loans by federal credit unions to any one member limited based on the credit union’s “unimpaired capital and surplus”); 12 U.S.C. § 1828(z) (added by Dodd-Frank § 615 to limit purchase and sales with insiders to “10 percent of the capital stock and surplus of the insured depository institution”); 12 C.F.R. § 215.2(i) (defining “unimpaired capital and unimpaired surplus” for purposes of bank exposure limits to insiders under Board’s Regulation O); 12 U.S.C. § 2015(b)(3)(A) (limit on Farm Credit Bank exposure to certain financial institutions based on “paid-in and unimpaired capital and surplus” of the financial institution); 12 U.S.C. § 3102 (limitations on Federal branch activities of an FBO are based on rules applicable to national banks, including that “any limitation or restriction based on the capital stock and surplus of a national bank shall be deemed to refer, as applied to a Federal branch or agency, to the dollar equivalent of the capital stock and surplus of the foreign bank”).

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stock and surplus” of the FBO.³¹⁸ We recognize that the Basel Large Exposure Consultation has proposed that large exposure limits should be based on either the Common Equity Tier 1 Capital or the Tier 1 Capital of the organization.³¹⁹ Depending on the outcome of the Basel Committee’s consideration of these issues, the Board may require revised statutory authority to apply a measure different than the plain words of Section 165(e)(2).

Also, as a practical matter, adopting such a limited approach would be both inefficient and unnecessary. Using such a limited denominator for the SCCL would then be more inconsistent with other similar limits than the SCCL already is,³²⁰ thus creating additional, significant and unnecessary burden for the financial industry to calculate various lending limits under divergent methodologies.

5. *We Fully Support the Comments on the Domestic Proposal’s SCCL as Submitted in the Joint Trade Associations Letter and Reiterate the Comments Expressed in Our Comment Letter on the Domestic Proposal*

As the Proposal asserts that it is generally seeking to remain consistent with the SCCLs in the Domestic Proposal (notwithstanding the significant divergences we have noted in these comments), the IIB reiterates and repeats its support, as set forth in our letter, dated April 30, 2012, for the recommendations set forth in the Joint Trade Associations Letter to the extent they relate to the SCCLs proposed for FBOs.

In particular, we would like to highlight, in brief, a few specific concerns from those comments:

(a) *The Calculation Methodology under the SCCL Overstates the Risk of the Included Exposures*

Although we were encouraged to see that the Board is undertaking a quantitative impact study on the appropriateness of the “major” SCCL, we were disappointed that the Board did not signal any change to the calculation methodology for the SCCL, particularly in relation to derivatives and securities financing transactions and the shift of exposure to protection providers without recognition of the necessity of double default for ultimate exposure. The absence of any mention of potential modifications to the calculation methodology is even more puzzling when, in the interim between the release of the Domestic Proposal and the release of the Proposal, the

³¹⁸ Compare Dodd-Frank Act § 165(g)(2) (permitting Board to create short-term debt limits based on the “capital stock and surplus of the company or on such other measure as the Board of Governors considers appropriate.”) Such “other measure” language does not appear in Dodd-Frank Act § 165(e)(2).

³¹⁹ See Basel Large Exposure Consultation at para. 43.

³²⁰ See, e.g., OCC Lending Limit Revisions (although modified recently to comport with Section 610 of the Dodd-Frank Act and effective July 1, 2013, the OCC did not suggest any change to the definition of “capital and surplus”)

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OCC released modifications to its legal lending limit rules endorsing the use of regulator-approved models.³²¹

The differences among the proposed SCCL methodology, on one hand, and the models used for determination of appropriate capital levels, the models used for internal risk management purposes, models used under OCC lending limits and the models used to determine compliance with home country large exposure limits,³²² on the other hand, create what in our view amounts to significant inefficiency with no appreciable reduction of systemic risk.

(b) Exposures to Central Counterparties Should Be Exempt

International rules, including Title VII of the Dodd-Frank Act, will soon require swap dealers to clear standardized derivatives through recognized central counterparties (“CCPs”).³²³ International regulators have made the policy decision that the reduction in counterparty exposure and netting benefits outweigh the potential costs of increased connections with CCPs and the concentration of risk in CCPs. To mitigate these costs and risks even further, international regulators have agreed to a set of prudential standards under which CCPs must operate.³²⁴

The Board should exempt exposures to CCPs from the coverage of the SCCL. The EU and U.K. large exposure limits would already exempt certain CCPs.³²⁵ In addition, in implementing Section 611 of the Dodd-Frank Act, several states, including New York, have specifically exempted exposure to CCPs from their legal lending limits.³²⁶

Whether or not exposure to CCPs is exempted as we and others have suggested, greater clarity is needed in relation to understanding the parties to whom exposure must be

³²¹ See OCC Lending Limit Revisions.

³²² See CRD, Art. 106-118 and Annex III; and CRD II, Art. 2. See also CEBS Technical Advice on the Large Exposure Limits, Part II.

³²³ The U.S. mandatory clearing requirement became effective on March 11, 2013 with regard to certain interest rate and credit index swaps. See CFTC, Clearing Requirement Determination Under Section 2(h) of the CEA; Final Rule, 77 Fed. Reg. 74,284, 74,320 (Dec. 13, 2012). Internationally, see, e.g., G20, Leaders’ Statement: The Pittsburgh Summit (Sept. 24-25, 2009); European Market Infrastructure Regulation (EMIR) (Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (July 4, 2012) (OJ L 201/7, July 27, 2012) at Art. 4). See generally discussion of international clearing mandates in FSB, OTC Derivatives Market Reforms: Fifth Progress Report on Implementation (Apr. 15, 2013).

³²⁴ See, e.g., Committee on Payment and Settlement Systems/International Organization of Securities Commissions, Principles for Financial Market Infrastructures (April 2012). See also Board, Financial Market Utilities, 77 Fed. Reg. 45,907 (Aug. 2, 2012); Title VIII of the Dodd-Frank Act.

³²⁵ See CRD II, Art. 24 (amending Article 113 of the CRD); CRD, Annex III, Part II, Para. 6; CRR, Article 389, Para. 1(j); FSA BIPRU 10.2.3A (Dec. 31, 2010).

³²⁶ See, e.g., NY Lending Limit Revisions § 117.5 (“a bank need not include credit exposures to a qualifying central counterparty that has been designated by the [FSOC] as a financial market utility that is, or is likely to become, systemically important”); Off. Code of Ga. § 7-1-285(a)(3) (defining a “person or corporation” to whom exposure is limited as excluding any “clearing organization registered or exempt from registration with” the CFTC, SEC or other federal agencies).

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measured. Depending on whether a financial institution is a principal to the transaction, is an intermediary (such as a broker-dealer or futures commission merchant) or potentially even the CCP itself, there will be multiple exposures to apportion to parties in the transaction (e.g., there may be exposures to the CCP, the intermediate agent or clearing clients in the same transaction).

(c) Greater Clarity is Needed on Minimizing the Scope of the Attribution Rule

Although the Proposal indicates that it “adopts a minimal scope of application of [the] attribution rule in order to minimize burden on [FBOs]”, neither the preamble nor the proposed regulatory text indicate what this minimal scope is. In fact, the regulatory text uses the same language as Section 165(e)(4) of the Dodd-Frank Act, and therefore it is difficult to discern any change in scope at all. There is also no explanatory guidance or clarity on how it should be applied.

The attribution rule may make logical sense in the context of limitations on transactions with affiliates under, e.g., Section 23A of the Federal Reserve Act, where information may be obtained from affiliates that is helpful to the overall analysis. However, significant practical issues arise if the Board were to apply the same principles to loans to third parties, since the lender would have only limited ability to identify indirect beneficiaries and would have no standing or privity of contract with such beneficiaries.

6. *Clarification of Proposed § 252.243*

Section 252.243 of the Proposal lists the gross exposure calculation methods for certain types of credit exposures, such as loans, leases, securities, etc., but does not list all of the types of extensions of credit included in the definition of credit exposure in Section 165(e)(3), such as deposits and acceptances. We assume deposits would be measured by the amount placed on deposit with the counterparty (similar to a loan), less any insured amount. With respect to acceptances, we assume the exposure of the accepting bank is measured as an exposure to the drawer of the acceptance in the amount of the acceptance (similar to a guarantee); and that the exposure of a purchaser of an acceptance is measured as an exposure to the accepting drawee bank in the amount of the amortized purchase price of the acceptance (similar to a bond held to maturity).

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V. Stress Testing Requirements for Foreign Banking Organizations and Their Intermediate Holding Companies

Our principal comments on the Proposal's stress testing requirements largely parallel our comments in Part II regarding the regulatory capital and capital planning requirements in the Proposal, with an added concern regarding application of stress testing requirements to FBOs with less than \$50 billion in global assets.

We recognize that stress testing and forward-looking capital planning have become key supervisory and risk management tools coming out of the recent financial crisis. Most of our members are subject to well-developed home country stress testing regimes developed in accordance with Basel Committee guidance.³²⁷ At the same time, in our view (and consistent with the Basel Committee guidance), stress testing is most effective when performed on a consolidated basis to provide a clear picture of the banking group's condition and relative stability. As a result, deference to home country stress testing regimes and a focus on information sharing to give host country supervisors sufficient insight into a bank's stress testing and results remain the superior overall approach in this area.

We agree with the Board's fundamental approach to stress tests for FBOs themselves, which would look to the FBO's home country stress testing regime to determine whether the home country conducts stress testing on a consolidated basis and whether the regime contains certain enumerated characteristics designed to ensure that it is "broadly consistent" with U.S. stress testing standards. In our view, this approach should be consistent with the Basel Committee's (and the Board's) emphasis on conducting stress testing on a consolidated basis. We have a number of suggestions, addressed below, regarding the scope of application of the Board's approach and some issues relating to its administration, but overall we believe the Proposal's treatment of FBOs should be effective and would be consistent with the Board's statutory mandate under Section 165.

By contrast, the Board's proposal to apply a separate U.S. stress testing regime to IHCs—which would simultaneously be subject to stress testing as subsidiaries of FBOs subject to home country stress testing on a consolidated basis—is in our view both unnecessary and redundant. Beyond our more basic objections to the IHC concept as a categorical requirement, discussed in Part I above, we have several concerns regarding the way the Proposal would apply stress testing requirements to IHCs.

A. Stress Testing Requirements for FBOs

We support the Board's basic implementation of Section 165 for FBOs insofar as it would look first to the FBO's home country stress testing regime and would not impose separate stress testing requirements for the U.S. branches or nonbank subsidiaries of such FBOs. In our view, this approach complies with the Board's mandate in Section 165. We would, however, offer the following suggestions regarding the scope and administration of this standard, assuming it is adopted as proposed.

³²⁷ Basel Committee, Principles for Sound Stress Testing Practices and Supervision (May 2009).

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1. *The Board Should Not Require Stress Testing for FBOs with Less than \$50 Billion in Global Consolidated Assets*

While we appreciate that the Board has attempted to tailor the application of stress test requirements to FBOs, and may perceive that it is limited to some degree by the total asset thresholds in Section 165 itself, we would respectfully urge the Board to further tailor the stress test requirement so as not to unnecessarily burden FBOs that present no risk to U.S. financial stability.

The Proposal would impose stress testing requirements on FBOs in two tiers. In the upper tier, FBOs that have combined U.S. assets of \$50 billion or more would need to be subject to a home country stress testing regime that meets certain enumerated conditions, and would be required to provide information to the Board regarding the results of the home country consolidated stress tests. Failure to comply with these requirements would trigger mandatory penalties, including asset maintenance requirements for U.S. branches, stress testing requirements for U.S. subsidiaries, and the possibility of discretionary penalties in the form of intragroup funding restrictions or local liquidity requirements.

In the lower tier, FBOs that fall below this threshold but nonetheless have \$10 billion or more in global assets would need to be subject to an adequate home country stress testing regime based on the same criteria but would not need to provide results to the Board. Penalties for non-compliance would include the mandatory penalties (branch asset maintenance requirements and U.S. subsidiary stress testing) but not discretionary penalties (intragroup funding restrictions and local liquidity requirements).

While we support the Proposal's limitation of the stress tests results reporting requirement to FBOs with combined U.S. assets of \$50 billion or more,³²⁸ in our view the application of stress test requirements to FBOs with global assets of between \$10 and \$50 billion should be left to the judgment of home country supervisors, as a requirement based on Section 165 would not be necessary to protect U.S. financial stability.

The Board indicates that the threshold for the second tier (\$10 billion in global assets) is grounded in the statutory threshold for stress testing in Section 165(i)(2). As previously noted, we remain of the view that the Board has more discretion than it has exercised to apply these thresholds to the U.S. assets of an FBO rather than global assets.³²⁹ However, even assuming the Board's discretion were limited as the Proposal suggests, the Board has significant authority to tailor stress testing requirements for FBOs and is required to consider comparable home country supervision, as demonstrated by the Board's decision not to apply all of Section 165(i)'s requirements to FBOs.³³⁰ The Board should exercise similar discretion to

³²⁸ We address the proposed penalties in Part VII below.

³²⁹ See Part I.A at note 9 above.

³³⁰ Dodd-Frank Section 165(i) requires BHCs and FBOs with more than \$10 billion in total consolidated assets to conduct annual company-run stress tests, and it requires BHCs and FBOs with \$50 billion or more in total consolidated assets to (i) undergo annual supervisory stress tests and (ii) conduct semi-annual company-run stress tests. In the proposal, the Board tailored this requirement to only require annual stress tests, either supervisory or company-run, from FBOs with more than \$10 billion in total consolidated assets, and to apply the full stress testing regime only on IHCs.

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effectively eliminate the Proposal's stress testing requirements for FBOs with less than \$50 billion in global consolidated assets by, for example, exempting FBOs from jurisdictions where similarly situated banks have been determined to be subject to comprehensive consolidated supervision. Allowing for such an accommodation would, in our view, be clearly justified in light of the fact that such firms cannot be reasonably deemed to pose a risk to U.S. financial stability.

2. *The Criteria for Evaluating a Home Country Stress Testing Regime Should Be Clarified*

The Proposal provides that a home country stress test regime must include (i) annual stress tests conducted on a (ii) consolidated basis by (iii) either the FBO's home country supervisor or by the FBO itself, if subject to review by the home country supervisor, and (iv) that it must include requirements for governance and controls of stress testing practices by the management and board of directors. The preamble suggests that the Board chose these four enumerated elements to ensure that the home country stress testing regime is "broadly consistent with the capital stress testing requirements of the Dodd-Frank Act." In our view, the four enumerated characteristics of a sound stress testing regime are generally appropriate and should leave sufficient flexibility for the Board to defer to a home country's reasonable implementation of FSB and Basel principles, rather than requiring point-by-point equivalence with the U.S. stress testing regime. However, we respectfully request the Board to confirm that the enumerated elements are the only elements required to satisfy the proposed requirement, and that no separate or additional "consistency" analysis of a home country's stress testing regime would be required.

3. *The Board Should Permit Deviation from the Four Enumerated Criteria under Appropriate Circumstances*

Especially in light of the penalties that would or could be imposed on an FBO's U.S. operations for failure to meet the required criteria for an adequate home country stress testing regime, we would respectfully suggest that the Board's evaluation should contemplate additional flexibility where it would be consistent with protecting U.S. financial stability. Procedurally, an FBO should be able to comply with the stress test requirement by demonstrating to the Board or the appropriate Reserve Bank that its stress testing regime deviates from the enumerated criteria in ways that do not present risks to U.S. financial stability. For example, especially for FBOs with limited U.S. footprints (*i.e.*, less than \$50 billion in U.S. assets), the Board should not require annual supervisory (or supervisor-reviewed) stress tests if the home country supervisor conducts stress testing on a multiyear cycle. For FBOs with larger U.S. footprints that are on a multiyear supervisory cycle with respect to their home country stress testing, the Board should consider alternatives to supervisory review of internal stress tests. For example, independent internal or external auditor review could substitute for supervisory review in the years between scheduled review by the FBO's supervisory authorities.³³¹

³³¹ Indeed, administration of this process for considering deviations from the four enumerated criteria could be another way to achieve the tailoring that we suggest would be appropriate in Part V.A.1 above. In other words, by allowing for more deviation from the enumerated criteria for FBOs in the lower tier, the Board could effectively achieve the same result as exempting those FBOs altogether (although with more burden on both the Board's resources and the FBOs').

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4. *The Board Should Modify the Information Requirements for FBOs with Combined U.S. Assets of \$50 Billion or More*

As a technical matter, we request that the Board clarify that the Proposal's requirements for information reporting on FBO stress tests would apply only to FBOs with combined U.S. assets of \$50 billion or more. Section 252.263(b)(1) of the proposed rule text provides that FBOs with total consolidated assets of \$50 billion or more must report summary information to the Board regarding their home country stress test results. However, throughout Section 252.263 and the preamble discussion of this portion of the rule text, these information requirements are presented as applicable only to FBOs with combined U.S. assets of \$50 billion or more. The reference to total consolidated assets as opposed to U.S. assets in Section 252.263 appears in this context to be a typographical error.

As a substantive matter, we urge the Board to tailor the Proposal's information reporting requirements for FBOs with combined U.S. assets of \$50 billion or more to match the content and timing of home country stress testing. If home country stress tests are concluded on a different cycle than the Board's preferred cycle, the Board should accept results from the home country stress tests at a reasonable interval after their completion. If home country stress tests do not produce the Board's requested metrics, the Board should accept alternative metrics, provided they are generally effective in depicting the soundness of the institution.

In addition, the Board should take appropriate precautions to protect the confidentiality of information relating to home country stress test results provided to the Board, including by treating all stress test results as confidential supervisory information exempt from disclosure under the Freedom of Information Act and, if necessary, entering into confidentiality agreements with the FBO and its home country regulators, as appropriate. Decisions regarding the extent of public disclosure of an FBO's stress tests results should lie solely with the home country supervisor.

We also request that the Board clarify what additional information it will require and what standards it will apply to determine whether an FBO that has a branch network in a net "due from" position with respect to the foreign bank parent or its international affiliates has adequate capital to "absorb losses in stressed conditions." In our view, the operative standards should be based on the FBO's own home country stress testing regime, and not, for example, Board-defined criteria.

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5. *The Board Should Adopt a Procedure for Imposing Penalties on the U.S. Operations of FBOs that Ensures Such Penalties Are Imposed Only if Required to Protect U.S. Financial Stability*

The Proposal contemplates both mandatory and discretionary (in the case of FBOs with \$50 billion or more in combined U.S. assets) penalties for non-compliance with the stress testing requirement. The penalties, which include asset maintenance requirements for branches, U.S. stress testing requirements for U.S. subsidiaries and potential intragroup funding restrictions and local liquidity requirements, would have potentially significant implications for many FBOs.

While we do not expect that many FBOs would fail to comply with the stress testing requirement as proposed (in view of the four enumerated criteria for an acceptable home country stress testing regime), we are nonetheless concerned that due to the potential significance of the penalties they not be imposed unless necessary to satisfy the Board's authority under Section 165 to protect U.S. financial stability. To that end, we would suggest the following procedural protections:

First, none of the penalties should be mandatory. Rather, the Board should retain discretion to impose the penalties on the basis of its assessment of financial stability risks, and the Board's proposed notice and opportunity to respond procedure for discretionary penalties should apply to all three categories of penalties.

Second, especially because the penalties flow from a perceived inadequacy in an FBO's home country stress testing regime, the Board should first consult with an FBO's home country supervisor before imposing any of the specified penalties.

Third, the Board should not impose any of the penalties absent a finding that the relevant deficiency in an FBO's home country stress testing regime, or failure to report results to the Board, presents a risk to U.S. financial stability.

6. *The Board Should Not Increase the Burden on FBOs through Additional U.S. Branch Stress Testing or Reporting Requirements*

Question 74 of the Proposal asks: "Should the Board consider conducting supervisory loss estimates on the U.S. branch and agency networks of large [FBOs] by requiring U.S. branches and agencies to submit data similar to that required to be submitted by U.S. [BHCs] with total consolidated assets of \$50 billion or more on the FR Y-14? Alternatively, should the Board consider requiring [FBOs] to conduct internal stress tests on their U.S. branch and agency networks?"

The Board should not increase the burden on FBOs by imposing additional U.S. branch stress testing or reporting requirements. Home country stress testing results will provide the Board with detailed information about an FBO's capital position and the ability of its branch network to withstand stressed conditions. Analysis of this information should be more than sufficient without requiring additional stress testing of an FBO's branch network. Because branches of a foreign bank do not separately maintain capital, capital stress tests would not be sufficiently meaningful in that context to warrant the additional burden.

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B. Stress Testing Requirements for IHCs

Our principal concern regarding the Proposal's stress testing requirements for IHCs largely parallels our concern regarding the Proposal's application of regulatory capital (including leverage ratio) requirements on IHCs and related capital planning requirements, as discussed in Part II.B above. Indeed, we recognize that stress testing and capital planning are tools directly connected to capital regulation. However, subjecting IHCs to a separate U.S. stress testing regime, without at least taking into consideration the IHC's unique posture of being wholly owned, the capital and financial strength of the parent FBO and the adequacy of the FBO's consolidated home country stress testing regime, would be inconsistent with the Board's mandate in Section 165.

In general, IHC stress testing should reflect the fundamental differences between U.S. top-tier BHCs, each of which issues publicly-traded shares and is the ultimate, controlling organization within its group, and IHCs, which would be wholly owned U.S. subsidiaries of FBOs. Among other things, in the normal course of their stress testing, IHCs would take into account potential scenarios that are not relevant to U.S. BHCs, such as the financial condition of their parent FBO and/or developments in the parent's home country. An FBO parent may require its IHC subsidiary to incorporate into its stress testing certain scenarios prescribed by the foreign bank as part of the global group's risk management. Stress testing requirements and standards prescribed by the FBO's home country supervisory authority may also be relevant to the IHC's stress tests. Furthermore, strategies and solutions for addressing deficiencies highlighted by a stress test at a wholly owned IHC are fundamentally different from those that could be used at a top-tier BHC.

1. *Alignment of IHC Stress Tests with FBO Stress Tests*

The Board should permit the IHC to adapt the Board's stress testing requirements to align with home country requirements in order to avoid potential conflicts, inconsistent results and duplicative efforts. By definition, in light of the FBO stress testing requirements discussed above, an IHC would be owned by an FBO whose home country stress testing regime is broadly consistent with the stress testing regime for U.S. BHCs. However, the Board should take into account methodologies of home country stress test regimes and permit modifications of any U.S. stress test requirements to reflect home country practices and requirements. Furthermore, the Board should coordinate stress testing timing and review with home country regulators.

2. *IHCs Should Be Permitted to Take Into Account in Their Stress Testing the Availability of Capital and Support from Their Parent FBO and Other Affiliates*

The Board should permit IHCs to make reasonable assumptions about the availability of capital and other support from an IHC's parent and affiliates in its stress testing projections. For example, IHCs should be permitted to take into account parent-level guarantees, contingent capital contributions and other inter-affiliate funding flows and credit support, provided that the IHC can demonstrate that, in a given scenario, the parent could provide such support. For example, a parent FBO can provide meaningful credit support to its subsidiaries by

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engaging in split hedges whereby positions in the subsidiary are hedged against loss with trades booked in the parent bank.

Moreover, as discussed in Part II.B.8, FBOs may support and fund their U.S. operations through a variety of means other than equity investments. IHCs, unlike top-tier U.S. BHCs, are likely to benefit from holding company debt investments that would essentially be transformed into loss-absorbing capital in a liquidation scenario. Accordingly, Tier 1 common equity would not necessarily be an appropriate measure of the financial strength or loss-absorbing capacity of an IHC, which would typically be wholly owned by its parent and which may be primarily funded with combinations of equity, subordinated debt and senior debt issued to the parent for tax, capital or other reasons. Therefore, we urge the Board to permit alternative measures of stressed financial strength for IHCs rather than focusing narrowly on Tier 1 common equity levels under stressed conditions.

3. *An IHC's Public Disclosure Requirements with respect to Stress Testing Should Be Tailored to Take Into Account Certain Considerations Particular to IHCs*

The Board should carefully consult with industry and individual FBOs before making any public disclosures of stress test results. IHCs do not operate independently of their parent FBOs, and therefore may generate misleading stress test results that may lead external stakeholders to reach false conclusions if the tests do not properly reflect the availability of support from the parent FBO and other affiliates (both from inside and outside the United States).

The Board should also ensure any public disclosure is consistent with home country requirements in terms of timing and content. We believe that such disclosures are likely to need to be coordinated with any similar disclosures or securities law disclosures required of the foreign banking organization parent. IHCs should be provided the flexibility to coordinate the form and timing of such disclosures, provided that they are released in a reasonably timely manner.

4. *Stress Testing Requirements Should Be Phased In to Provide FBOs Adequate Time to Develop the Necessary Infrastructure within Their IHCs*

The Board should provide a phase-in period of two to three years after the effective date to permit FBOs to adapt to the new stress testing requirements for IHCs. During the phase-in period, IHCs subject to stress testing would conduct stress testing and receive feedback from the Board, but would not be subject to sanctions for performing a stress test that the Board determines to be deficient in some respect.

We also urge the Board to consider delaying public disclosure of supervisory stress tests for IHCs for two to three years after the effective date. Such a transition period would be important in light of the intense market sensitivity that has characterized the publication of results from the Board's Supervisory Capital Assessment Program ("SCAP") and its Comprehensive Capital Analysis Review ("CCAR"). Subjecting newly established IHCs to

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such elevated scrutiny in their first years of operation as they are developing stress testing procedures and infrastructure is unnecessary and inappropriate. The Board has recently provided similar relief to U.S. BHCs whose total consolidated assets equal or exceed \$50 billion and are subject to its Capital Plan Review Program (“CapPR”) by determining not to publish the supervisory stress test results of those BHCs. Although these BHCs subject to the CapPR are deemed systemically significant under the Dodd-Frank Act and are therefore subject to supervisory stress tests, the Board has not yet published the results of the CapPR stress tests although it has published the supervisory stress test results of BHCs subject to the SCAP and CCAR for each of the last three years.

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VI. Early Remediation Framework and Potential Debt-to-Equity Limits

The IIB supports the overall objective of Section 166, which directs the Board to prescribe regulations that “establish a series of specific remedial actions” that would apply to U.S. BHCs and the U.S. operations of FBOs in financial distress “in order to minimize the probability that the company will become insolvent and the potential harm of such insolvency to the financial stability of the United States.”³³² The Board has broad discretion to implement this directive. Indeed, the statutory language provides minimal instructions regarding the content of the regulations, stating only that they should “define measures of the financial condition of the company” and “establish requirements that increase in stringency as the financial condition of the company declines,” and providing some basic direction regarding the metrics for measurement of financial condition and the remedial actions that should be included in the rule.³³³

The same underlying policies and statutory mandates that apply in the case of the Section 165 Standards should also guide the Board’s implementation of Section 166. The explicit purpose of both Sections 165 and 166 is to prevent or mitigate risks to U.S. financial stability, and each applies to the same scope of institutions. For this reason, we would urge the Board to implement the early remediation requirements applicable to FBOs in a manner that is more tailored to the individual and shared characteristics of, and risks presented by, FBOs.

A. The Board Should Tailor Application of Early Remediation Measures to Reflect the Systemic Relevance of an FBO’s U.S. Operations

1. *The Board Should Not Apply the Early Remediation Regime to FBOs with Less Than \$50 Billion in Combined U.S. Assets*

While we appreciate the Board’s attempt to tailor its proposed early remediation regime and relieve some of the burden on FBOs with smaller U.S. footprints, more tailoring is warranted. Section 166 is focused on the potential harm to U.S. financial stability that would result from the failure of a BHC or FBO. The prospect that an FBO with less than \$50 billion in U.S. assets could harm U.S. financial stability is remote. Excluding FBOs below that threshold from the scope of the early remediation regime would not meaningfully interfere with the Board’s objective of preserving the stability of the U.S. financial system.

The Proposal recognizes the limited importance of this class of FBOs by making the application of remediation measures discretionary, as opposed to the mandatory application of measures for FBOs with more than \$50 billion in combined U.S. assets. And the Board indicates in the preamble to the Proposal that its criteria for deciding whether to impose a

³³² Dodd-Frank § 166.

³³³ *Id.* (“[The Board shall] define measures of the financial condition of the company, including regulatory capital, liquidity measures, and other forward-looking indicators; and (2) establish requirements that increase in stringency as the financial condition of the company declines, including—(A) requirements in the initial stages of financial decline, including limits on capital distributions, acquisitions, and asset growth; and (B) requirements at later stages of financial decline, including a capital restoration plan and capital-raising requirements, limits on transactions with affiliates, management changes, and asset sales.”).

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specific remediation measure include “risk to U.S. financial stability posed by the [FBO].”³³⁴ While we believe that the application of specific remediation measures should be discretionary for any FBO that is subject to the early remediation regime (as discussed below), in this context the distinction between discretionary and mandatory application of remediation measures will have little practical significance. Few FBOs would be willing to rely on the possibility of Board restraint in the event they cross an early remediation trigger. As a result, we expect most FBOs covered by the early remediation regime will manage their operations to remain above the triggers, even if they are below the \$50 billion U.S. asset threshold for mandatory remediation measures.

Rather than requiring FBOs of minimal systemic importance to manage to a complicated matrix of remediation triggers and potential remediation measures, the Board should exclude them from the early remediation regime and instead continue to rely on its ample range of regular supervisory powers to address microprudential concerns on a case-by-case basis.

2. *The Board Should Apply Remediation Measures on a Discretionary Basis for FBOs that Cross Remediation Triggers*

As currently proposed, the early remediation regime is too inflexible and is likely to result in the application of inappropriate and potentially counterproductive remediation measures if an FBO trips a remediation trigger. Rather than hardwiring the regime so that each progressive remediation level triggers the automatic application of multiple remediation measures, the Board should retain supervisory discretion to apply only those measures that are likely to accomplish the goals of early remediation—preventing institutional insolvency and protecting U.S. financial stability. As discussed in more detail below, some of the remediation measures in the Proposed Rule could have procyclical effects, especially if applied automatically.

The need for supervisory discretion in the application of remediation measures is especially important for FBOs where a significant portion of their operations will be subject to other legal and supervisory regimes outside of the United States and outside the scope of the remediation measures available to the Board. FBOs could be subject to a variety of potential stresses that could trigger the early remediation regime, from a variety of sources. In some cases, stress at an FBO’s non-U.S. operations might impact its U.S. operations. In other cases, a disruption in U.S. markets or a problem at a U.S. branch or subsidiary could trigger remediation. As proposed, it would also be possible for an FBO to trigger remediation measures based solely on developments outside of the United States that may have no bearing on the viability of an FBO’s U.S. operations. The appropriate response will necessarily vary depending on the nature and source of the triggering event. It may be that the most appropriate response would come from outside of the United States, and the only remediation measures that would be warranted inside the United States would be enhanced monitoring until the situation is resolved.

Discretionary application of remediation measures would give effect to two of the fundamental principles underlying the Section 165 framework. It would permit the Board to take

³³⁴ 77 Fed. Reg. at 76,672. We would respectfully suggest that these intended criteria, while helpful, should be added to the text of the regulation.

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into consideration the existence of home country supervisory measures that would address concerns at the consolidated level, and it would permit the Board to tailor remedial measures to match the actual sources of systemic risk presented by a particular FBO.

B. The Need for Cooperation and Coordination with Home Country Authorities

There are important international initiatives underway to bolster cross-border cooperation and coordination in identifying and addressing distressed institutions. The efforts of the FSB on recovery and resolution planning are at the center of these efforts, and many jurisdictions, including the United States, are strengthening their own SIFI surveillance, recovery and resolution regimes.³³⁵ In our view, a fundamental principle of any host country SIFI remediation framework should be consultation and coordination with home country authorities. The posture of foreign-owned branches and subsidiaries operating in a host country with respect to that host country's supervisors is fundamentally different than the posture of a domestic banking organization headquartered in that country. Most important, foreign-owned branches and subsidiaries operating in a host country are part of a larger consolidated group, and have the ability to rely on their parent's capital and liquidity to support their activities and to serve as a source of strength during periods of stress. In addition, a host country supervisor will depend to a greater degree on home country supervisors for insight into the health of a foreign bank's global consolidated operations, and the likely effectiveness of any remedial actions taken with respect to the foreign bank, than in the case of a home country supervisor with comprehensive consolidated oversight of a domestic bank.

Because of these fundamental differences, we urge the Board to expressly provide for prior consultation and coordination with home country authorities before any U.S. remedial actions are taken under Section 166 with regard to an FBO. At a minimum, the final rule should require consultation prior to any remedial actions beyond the targeted supervisory review triggered by "Level 1" remediation in the Proposal. The Board's authority to take remedial measures to protect U.S. financial stability would not be curtailed by prior consultation with home country supervisors. On the contrary, consultation should help the Board design tailored remediation measures targeted to the specific issues facing an FBO that may find itself, or its U.S. operations, in a troubled condition. It may also open the door for coordinated action to remedy perceived deficiencies, as in some cases the FBO's home country supervisor will be in a better position to take effective remedial actions. If the FBO's home country supervisor is actively taking steps to address weaknesses identified under the early remediation framework, the Board should be willing to defer to that supervisor.

Incorporating an explicit home-host coordination requirement in the Board's regulation implementing Section 166 would make it more consistent with the work being done not only in the recovery and resolution planning context, but also in the ongoing supervisory

³³⁵ See, e.g., FSB, Recovery and Resolution Planning: Making the Key Attributes Requirements Operational (Nov. 2012) (requesting public comments on recovery and resolution planning guidance); Resolution of Systemically Important Financial Institutions (Nov. 2012) (describing international and home country progress towards implementing harmonized resolution planning processes); Key Attributes of Effective Resolution Regimes for Financial Institutions (Oct. 2011).

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context, where bilateral (and trilateral) discussions among the Board and its non-U.S. counterparts have increased with positive effects. Such a requirement would also help reduce the unilateral character of the early remediation regime, which would be important in light of the fact that early remediation measures have direct implications for the parent FBO and in some cases may be triggered by events occurring at the parent FBO.

C. Consolidated Capital-Based Remediation Triggers Would Effectively Impose Risk-Based Capital and Leverage Ratio Surcharges on an FBO's Global Operations

The Board's proposed capital-based remediation triggers would effectively increase the minimum risk-based capital and leverage requirements for an FBO's global consolidated operations, further exacerbating costs of the Proposal's capital requirements and further reducing FBOs' flexibility to efficiently manage global capital.³³⁶ Under the Proposal, "Level 2" remediation could be triggered if an FBO's global consolidated operations were to fall below a risk-based capital ratio 200 to 250 basis points above the relevant minimum, or a leverage ratio 75 to 125 basis points above the relevant minimum (in each case with the relevant minimum based on home country implementation of the Basel Capital Framework). Therefore, the Proposal would effectively require an FBO to maintain a leverage ratio of 3.75% to 4.25% at a consolidated level once the Basel III 3% leverage ratio takes effect in 2018 in order to avoid the prospect of early remediation measures being imposed on its U.S. operations.³³⁷ Similarly, an FBO's minimum Tier 1 common equity risk-based capital requirement would effectively increase from 4.5% to somewhere between 6.5% and 7%.³³⁸

³³⁶ For a discussion of the Proposal's capital provisions more generally, see Part II above.

³³⁷ Although the remediation measures are only automatic for FBOs with \$50 billion or more in combined U.S. assets, smaller FBOs subject to the proposed "discretionary" remediation regime would also need as a practical matter to manage to these higher capital levels in order to avoid potential regulatory penalties.

³³⁸ We understand the Proposal would apply the early remediation "surcharge" to the Basel III minimum risk-based capital ratios applicable to an FBO's global operations under its home country capital regime, and not to any of the proposed Basel III capital buffers or capital surcharges (e.g., excluding the capital conservation buffer, countercyclical capital buffer, G-SIB surcharge or D-SIB surcharge, to the extent they apply). The Proposal consistently distinguishes between the minimum risk-based capital standards applicable under Basel III on the one hand and the Basel III capital buffers on the other. For example, Section 252.282 of the Proposal (which establishes the early remediation triggers) refers specifically to the "minimum applicable risk-based capital standards . . . under subpart L" (emphasis added). Subpart L, in turn, refers to "minimum risk-based capital ratios" and "restrictions based on applicable capital buffers set forth in Basel III" as distinct regulatory capital requirements. See Proposal §§ 252.212(c)(2) and 252.282(a)(1)(A). See also 77 Fed. Reg. at 76,641 ("The proposal defines the Basel Capital Framework as the regulatory capital framework published by the [Basel Committee], as amended from time to time. This requirement would include the standards in the Basel III Accord for minimum risk-based capital ratios and restrictions and limitations if capital conservation buffers above the minimum ratios are not maintained, as these requirements would come into effect under the transitional provisions included in the Basel III Accord.") (emphasis added).

We agree that any early remediation surcharge above Basel III risk-based capital ratios should be based on the minimum ratios, and not applied on top of the Basel III surcharges and buffers. If, on the other hand, the Board intended to apply the early remediation surcharges on top of one or more of the Basel III capital surcharges or buffers, we would have significantly greater concerns regarding the unilateral and redundant nature of the surcharges.

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The application of remediation measures to an FBO based on a surcharge imposed by the Board above the FBO's home country minimum capital standards would be inconsistent with the principle of deference to comparable home country regulation underlying Section 165 and 166. Although the Proposal compares the "Level 2" capital triggers to the capital conservation buffer in the Basel Capital Framework,³³⁹ there are significant differences that make the Proposal's early remediation surcharge significantly more onerous. The Basel III capital conservation buffer will apply only to a banking organization's minimum risk-based capital ratios, whereas the early remediation regime would apply surcharges to both risk-based capital and leverage minimums, effectively increasing leverage requirements beyond the agreed Basel III minimum leverage ratio. Moreover, the Basel III capital conservation buffer will be phased in incrementally beginning in 2016, and will not fully take effect until January 1, 2019. The Proposal's early remediation requirements would take effect January 1, 2015, which would significantly accelerate and expand the effective application of the Basel III capital conservation buffer to FBOs.

FBOs doing business in the United States are already and will continue to be subject to consolidated capital regulation pursuant to internationally agreed-upon capital standards set by the Basel Committee and implemented by their home country supervisors. The Board's proposed unilateral imposition of remedial requirements based on buffers above home country minimum capital standards—without any proposed consultation with home country supervisors—not only violates the principle of deference to home country capital standards that has guided Board and international regulatory policy for decades, but also has the potential to undermine the international coordination of capital regulation that motivated development of the Basel Capital Framework. If the Board believes that minimum risk-based capital or leverage requirements are too low at the international level, it should address those concerns through international agreement and negotiation at the Basel Committee and other appropriate fora.

If the Board decides to retain early remediation triggers based on the parent FBO's home country capital, then we would recommend a few modifications to the currently proposed framework:

- First, the Board should modify the capital elements of the early remediation triggers to align them with an FBO's home country implementation of the Basel Capital Accord. To the extent the early remediation triggers apply a surcharge beyond the FBO's minimum home country capital requirements, the surcharge should be aligned with the corresponding home country buffer (i.e., in this context, the capital conservation buffer).
- Second, the Board should clarify that the capital triggers apply only to the foreign bank that directly operates the relevant U.S. branches. In our view, the remediation triggers based on home country capital are best understood as addressing the capital of foreign banks with branches in the United States, just as the IHC capital remediation triggers address the capital of an FBO's banking and nonbanking financial subsidiaries in the United States. Monitoring the capital of a foreign bank that is directly engaged in banking in the United States through its U.S. branches should be sufficient to protect the U.S. operations from any deterioration in capital, just as monitoring the capital of a U.S.

³³⁹ 77 Fed. Reg. at 76,671, n. 123.

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IHC over an FBO's U.S. subsidiaries is sufficient to protect those subsidiaries from capital deterioration. It would be an unnecessary and unjustified expansion of scope to reach beyond a foreign bank with U.S. branches and apply further capital triggers to that foreign bank's parent, whether it be another foreign bank, some other type of regulated financial company, or a diversified financial (or mixed commercial/financial) holding company. In addition, not all top-tier FBO parents are subject to consolidated bank regulatory capital standards; some are merely holding companies or cooperative organizations that sit above regulated banking organizations, while others are regulated under different regulatory schemes (e.g., as insurance companies).³⁴⁰

The Proposal would also base early remediation triggers on an IHC's risk-based capital and leverage ratios. We have discussed our objections to the Board's application of capital requirements to IHCs, and the IHC requirement more generally, in detail in Parts I and II above. We merely note here that the Proposal's early remediation capital "buffer" for IHCs would exacerbate the added burden and costs an FBO will incur in complying with both U.S. and home country capital requirements, making the problems outlined in our previous discussion more severe.

D. The Automatic "Cross-Default" Feature of the Early Remediation Regime Should Be Eliminated

Under the Proposal, each of the early remediation triggers applies to one or more separate parts of the FBO's operations. Stress test requirements would lead to "Level 2" or "Level 3" remediation only if an FBO's IHC failed the stress test triggers. On the other hand, capital adequacy thresholds and market indicators (when adopted by the Board), would apply separately to the IHC on the one hand and the FBO's global operations (including the U.S. branches and the IHC) on the other. For other remediation triggers, such as the risk management and liquidity risk management requirements, the Board would scrutinize each part of the U.S. operations of the FBO separately for weaknesses, deficiencies or non-compliance.

Despite drawing distinctions between different parts of the organization for purposes of measuring remediation triggers, remediation measures would be imposed on all of an FBO's combined U.S. operations without regard for the source of the trigger. Thus, problems at an IHC would result in application of remediation measures to the FBO's entire U.S. operations, including parts of the FBO that are not connected to the IHC, such as the FBO's branch network. Similarly, early remediation measures would be applied to an FBO's IHC if problems at the FBO's branches or even—depending on the trigger—its home office activate a remediation trigger. This "cross-default" feature of the early remediation regime is inconsistent with the general structure of the Proposal, which frequently (even if problematically) treats an IHC as independent from the FBO's branches and global operations. Consequently, this feature could lead to inappropriate and unfair sanctions on one part of an FBO's organization for actions or events that occur in different operations or even different countries.

³⁴⁰ At a minimum, the Board should not indirectly apply capital standards to FBOs that are not already subject to home country bank regulatory capital requirements.

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For example, an IHC's officers and board of directors would face limits on compensation and potential dismissal or replacement if its parent's global consolidated capital falls below the "Level 3" remediation triggers, even if the IHC's capital levels remain well above the remediation triggers. Such officers and directors are likely to have no influence on any decisions or developments that pertain to weaknesses in the FBO's global operations, and it would be unfair to penalize them for the action (or inaction) of another part of the organization. Indeed, penalizing the officers and board members of an IHC could lead to departures of talented management and weaken a healthy IHC that could otherwise assist its parent's recovery. The automatic restrictions on capital distributions from an IHC (and funding from an FBO's U.S. branch network) upward to the FBO's parent company could also prevent an FBO's healthy U.S. operations from playing an effective role in the parent's recovery. If such "protective" measures prevent the recovery of the parent FBO, the collateral effects of the parent's failure could harm the FBO's U.S. operations.

We appreciate that there would be important connections among an FBO's non-U.S. operations, its U.S. branch network and its IHC (if any). As we have described above, we believe that IHCs and U.S. branches of many FBOs cannot be understood or evaluated without taking into account the strength and needs of their parent institutions. Instead, we urge the Board to adopt a remediation regime that reflects the variety of interconnections that exist between an FBO's U.S. and non-U.S. operations, accepts the possibility that it will sometimes be appropriate for an FBO's U.S. operations to support its non-U.S. operations and provides the flexibility for the Board to fashion appropriate, tailored measures in coordination with an FBO's home country supervisors to put a troubled FBO on a path to recovery. Nevertheless, as a general matter, an IHC, as a separately managed and capitalized U.S. holding company, should not be automatically subject to remediation measures caused by home country or branch activities. Similarly, an FBO's U.S. branches should not be automatically subject to remediation measures triggered solely by the actions of an IHC, so long as the overall SI-FBO remains in sound condition and remediation measures at the IHC level would be sufficient to remedy any weaknesses.

E. Any Market-based Triggers Should Be Carefully Calibrated for the Unique Circumstances of FBOs

We appreciate the Board's continued careful consideration of the most appropriate way to implement market-based remediation triggers for both U.S. BHCs and FBOs. The development of market-based triggers would be complicated for any type of banking organization. If implemented incorrectly, they have the potential to accelerate a downward spiral in stress scenarios and would be vulnerable to "false positives" and "false negatives." Among other issues, the Board should continue to consider carefully the risk that publication of market-based triggers could create signals or incentives that might lead to runs on a financial institution or encourage speculative attacks on an institution's stock.

These complexities will be especially challenging for FBOs, where the U.S. footprint of an FBO may have only limited significance for the FBO's overall operations, and where events outside the United States that could have a significant effect on the market's view of the FBO's overall operations may have only limited significance for the FBO's U.S. subsidiaries. In addition, market indicators may not be readily available for the U.S. subsidiaries

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and branches of an FBO, and, depending on the markets in which the FBO is traded, head office market indicators may not accurately reflect the FBO's global operations. The Board should therefore carefully calibrate any market-based triggers it implements to account for the unique circumstances of FBOs operating in the United States.

The IIB supports the Board's appropriate caution in developing these triggers, and agrees that limiting market-based triggers to a "Level 1" supervisory review, excluding other automatic remedial measures, is an appropriate way to minimize potential unintended effects from implementing market-based triggers. The IIB looks forward to commenting directly on individual market-based metrics when proposed by the Board.

F. Certain Early Remediation Measures Could Have Procyclical Effects

The IIB is concerned that automatic application of the proposed early remediation measures could have a procyclical effect, accelerating the failure of an FBO that might otherwise be able to manage a recovery. In particular, limits on capital distributions and net funding positions could have a procyclical effect on a troubled FBO, especially when the FBO's U.S. operations are in relatively sound condition and are capable of providing support to the FBO's other operations. A troubled FBO could be prevented from receiving capital or liquidity from a source that is normally available precisely when it might be hard-pressed to find alternative sources of support or have trouble accessing the markets. The remediation framework could thus have the effect of intensifying crises by accelerating a firm's downward spiral.

The requirement under "Level 2" remediation that branches must maintain all 30 days of their liquidity buffer in the United States, as opposed to only the first 14 days, could result in similar procyclical stresses on an FBO. Pulling funding out of the FBO's global pool of liquidity when an FBO is undergoing stress would inappropriately limit the FBO's ability to react to the stress, and could interfere with an effective response. Indeed, the Board at least implicitly supports the use of a liquidity buffer under stressed conditions, because the Proposal appears to eliminate any liquidity buffer requirement for firms that fall into "Level 3" remediation.³⁴¹ We respectfully suggest that permitting FBOs more flexibility to use their liquidity buffer to address temporary stresses at an earlier point in a stress cycle could prevent some FBOs from further decline. Rather than a categorical requirement, the Board should adopt a case-by-case approach to liquidity that would allow the Board to work with a troubled FBO and its home country regulators to craft efficient responses to stress.

We are also concerned that the compensation limits and discretionary power to remove officers and directors of an FBO's U.S. operations in "Level 3" remediation could, if triggered, result in departures of qualified and critical personnel, even when the U.S. operations of an FBO are in sound condition. In addition to the potential unfairness of this result, loss of talented management personnel could undermine the stability of a firm's U.S. operations at exactly the time when the parent FBO can least afford disruptions.

³⁴¹ See Part III.B.3.1.

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G. An FBO’s Early Remediation Status and Other Firm-Specific Communications and Information regarding Early Remediation Should Be Treated as Confidential Supervisory Information

Given the sensitive and potentially market-moving nature of information that would be shared between an FBO, its home country supervisors and the Board in connection with evaluating an FBO’s status under the early remediation regime, we strongly encourage the Board to treat all such information and communications as confidential supervisory information exempt from disclosure under the Freedom of Information Act.³⁴² Special sensitivity should be given to the privacy laws and confidentiality concerns of home country regulators, to avoid any disclosures or information releases that could have inadvertent negative effects on the FBO’s home country operations.

H. Any Eventual Application of Section 165’s Discretionary Debt-to-Equity Limit Should Be Coordinated with Home Country Supervisors

The Proposal would, pursuant to Section 165(j) of the Dodd-Frank Act, impose a 15-to-1 debt-to-equity limit on an FBO based upon a finding by the FSOC that the FBO poses a “grave threat” to U.S. financial stability. We expect that this particular authority will rarely if ever be used, since any FBO that could be deemed to present a “grave threat” to U.S. financial stability would most likely have been subject to a variety of supervisory and regulatory requirements long before such a finding would be made. However, given the sensitivities surrounding such a determination, we strongly urge the Board and FSOC to coordinate and consult with the FBO’s home country supervisors prior to making any such finding.

If the Board were to apply this requirement to an FBO, we note that it would have the same infirmities that the rest of the Proposal has, namely that as proposed it would apply to an FBO’s U.S. branch network and its U.S. IHC without regard to the status or operations of the FBO as a whole, including whether the FBO is subject to comparable limitations on a consolidated basis, and it would lack the flexibility to provide a targeted response to the particular risks presented by an FBO. We urge the FSOC and the Board to take these considerations into account in any situation where they are considering applying this provision of Section 165.

³⁴² 5 U.S.C. § 522(b)(8).

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VII. Risk Management Requirements

A. The Proposal's Risk Management Requirements Should Include Greater Deference to Home Country Standards and Accommodate an Appropriate Range of Sound and Efficient Risk Management Practices

The IIB fully supports the Board's emphasis on enhanced risk management and agrees that a robust risk management function is critical for all FBOs. Effective risk management (including management of liquidity risk), prudent business practices and strong consolidated capital levels are the most important factors in preventing distress at financial institutions and potential threats to financial stability. We are concerned, however, that certain of the risk management requirements in the Proposal are overly prescriptive and potentially counterproductive, particularly in the context of cross-border banking operations.

In the last few years, significant time and resources have been devoted to enhancing effective governance and risk management, not only by individual FBOs, but also by their home country regulators and international coordinating bodies.³⁴³ The FSB's recently completed peer review of risk governance regulatory requirements and industry practices found that "many of the best risk governance practices at surveyed firms are now more advanced than national guidance."³⁴⁴ The report further found that gaps still remain in national supervisory guidance regarding risk management and in industry risk management practices.³⁴⁵ More work remains to be done. But we believe that the developments of the last few years demonstrate the dedication of both the industry and regulators to improve consolidated risk management practices and supervision.

Given this context, it will be important to balance the Board's interest in ensuring U.S. risks are prudently managed with a recognition that U.S. risks should be effectively managed as part of a global risk management framework. It is also important to ensure that U.S. risk management requirements are not designed in ways that detract from, or distract management resources away from, meeting the paramount objective of effective global risk management (including as applied to cross-border banking operations). We also believe the Board should avoid imposing specific procedural and governance requirements that are too inflexible to accommodate sound and efficient risk management practices at FBOs with diverse operational and management frameworks and that operate disparate business lines across multiple jurisdictions.

In our view, a flexible, tailored approach to the Proposal's risk management requirements, designed along the lines of the SI-FBO Framework, would be more effective in addressing the Board's underlying concerns while taking into account the risk management practices and other indicators of financial and managerial strength at individual FBOs.

³⁴³ See, e.g., FSB, Thematic Review on Risk Governance: Peer Review Report (Feb. 13, 2013); FSB, Senior Supervisor's Group, Risk Management Lessons from the Global Banking Crisis of 2008 (Oct. 21, 2009).

³⁴⁴ FSB, Thematic Review on Risk Governance: Peer Review Report at 2.

³⁴⁵ Id.

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1. *The Board Has Significant Flexibility under Section 165 to Tailor Risk Management Requirements for FBOs*

We understand that Section 165(h) specifies that the Board must require publicly traded BHCs with \$10 billion or more in total consolidated assets to establish a risk committee, that Section 165(b)(1)(A) requires the Board to prescribe overall risk management requirements for BHCs with over \$50 billion in assets and that Dodd-Frank Section 102(a)(1) defines BHCs to include FBOs. We also agree that it is appropriate for the Board to scrutinize the U.S. risk management practices of FBOs as a part of its ongoing supervisory responsibilities and in connection with its role as systemic risk supervisor. However, we believe the Board has significantly more flexibility to tailor application of the Section 165 risk management requirement to FBOs than it has exercised in the Proposal.

First, Section 165(b)(1)(A) leaves the design of “overall risk management requirements” to the Board’s discretion. Second, Section 165(h)’s only specific requirements for a Section 165 risk committee is that it must be “responsible for the enterprise-wide risk management practices” of the regulated BHC or FBO, and that the committee must have at least one risk management expert. Third, in the case of FBOs these quite general grants of authority should be interpreted in connection with the clear statutory directions to focus on consolidated supervision, to take into account comparable home country standards and to tailor Section 165’s requirements to the risk profile of the institutions in question.³⁴⁶ Read together, we believe these provisions require the Board to defer to comparable consolidated home country risk management standards and to forbear in most cases from applying any U.S.-specific risk committee or other risk management requirements, absent a specific finding that the risk management practices of an FBO, taken in light of its overall U.S. operations, may create a systemic risk for the United States.³⁴⁷ We urge the Board to take a more tailored and deferential approach to its assessment of FBO risk management. In view of the Board’s extensive experience examining the risk management practices of FBOs in the United States, there should be no concern that additional flexibility would lead to additional, unaddressed risks.

2. *The Board Appropriately Permits the U.S. Risk Committee to Be Organized as a Head Office Committee*

We support the flexibility the Board provides in the Proposal for the U.S. risk committee to be organized as a committee of the global board of directors (or its equivalent), on a standalone basis or as part of an enterprise-wide risk committee. We agree that for some institutions a U.S. risk committee would not need to be housed in a U.S. subsidiary or other U.S.

³⁴⁶ See Parts I.A.2 – I.A.3 above.

³⁴⁷ The fact that Congress not only did not mention a specific, U.S.-focused risk committee in Section 165, but instead in Section 165(h) specifically stated that the Section 165 risk committee “shall . . . be responsible for the oversight of the enterprise-wide risk management practices” of the BHC or FBO, strongly suggests that Congress intended the Board to focus on the enterprise-wide risk management of FBOs according to their home country standards, as does Section 165(b)(2)(B)’s direction for the Board to “take into account the extent to which the foreign financial company is subject on a consolidated basis to home country standards that are comparable to those applied to financial companies in the United States” (emphases added).

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operation. However, we would suggest that the U.S. risk committee requirement be more tailored and made more flexible as outlined below.

3. *The Board Should Exempt All FBOs with Less than \$50 Billion in U.S. Assets from the U.S. Risk Committee Requirements*

We appreciate the Board's attempt to tailor the Section 165 risk management standards to FBOs of different sizes.³⁴⁸ However, we respectfully suggest that even the few requirements for FBOs with less than \$50 billion in U.S. assets are both unnecessary and inconsistent with the statutory intent of Section 165. In our view, there is no need to require FBOs with small U.S. footprints to devote formal governance structures to U.S. risk management outside of their preexisting enterprise-wide and U.S. based risk management functions.

For FBOs with less than \$50 billion in U.S. assets, assessing compliance with Section 165(h) should only require (i) certification of compliance with home country implementation of Basel Committee risk management guidance,³⁴⁹ and (ii) continued monitoring of the FBO's risk management practices in the United States through the Board's preexisting supervisory processes. Because nothing in Section 165 requires a separate U.S. risk committee, certification of compliance with internationally accepted risk management standards would be an appropriate adaptation of Section 165(h) for FBOs with small U.S. footprints.

4. *The Board Should Generally Defer to Home Country Supervision of Risk Management Practices at FBOs with \$50 Billion or More in U.S. Assets*

For FBOs with \$50 billion or more in U.S. assets, we urge the Board to take an approach more closely tailored to the actual risks presented by an FBO, and one that considers the extent of home country standards governing the FBO's consolidated risk management functions. We expect that a properly deferential approach to risk management would find that most FBOs with larger (\$50 billion or more) U.S. footprints are subject to direct, substantive supervision regarding their risk management practices. Although the exact expectations and requirements under particular home country regimes are likely to differ, we also expect that the Board will find that most home country supervisors are continuing to raise their expectations regarding a firm's consolidated risk management.³⁵⁰ While we understand that the Board is interested in clear lines of communication and designated centers of responsibility with respect to these FBOs' U.S. operations, it should refrain from prescribing specific roles and structures for an FBO's risk management function. Again, there is nothing in Section 165 that requires an FBO to have a separate U.S. risk committee or CRO, so the Board has ample authority to modify its expectations to reflect the management and governance models of FBOs with U.S. operations.

³⁴⁸ The Proposal would limit its most prescriptive requirements to FBOs with \$50 billion or more in combined U.S. assets, although some specific governance requirements—formation of and certification to the fact that the FBO has a U.S. risk committee as part of its global board of directors or as part of its IHC board of directors—would still apply to FBOs with smaller U.S. footprints.

³⁴⁹ See, e.g., Basel Committee, Principles for Enhancing Corporate Governance (Oct. 2010) (describing principles for effective risk management and internal controls).

³⁵⁰ See FSB, Thematic Review on Risk Governance: Peer Review Report.

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As a default rule, the Board should defer to a larger FBO's preexisting risk management structure so long as (i) the FBO certifies compliance with home country implementation of Basel Committee risk management guidance, (ii) the FBO identifies to the Board the managing or governing body that is responsible for U.S. risk management (which could be the FBO's global enterprise-wide risk committee or a subcommittee thereof, a special board of managers designated for the United States, or some other governance structure consistent with the FBO's overall management and governance), (iii) the FBO identifies a senior officer who will serve as the point of contact responsible for all communications with the Board regarding the FBO's U.S. risk management, (iv) the Board is satisfied with its timely access to all information relevant to the FBO's U.S. risk profile and (v) the Board has not made a specific finding that the risk management practices of an FBO, taken in light of its overall U.S. operations, may create a systemic risk for the United States.

(a) The Board Should Defer to Home Country Judgments regarding Appropriate Risk Management Structures

Our proposal is based on the general principle that internationally active banks should have the ability to take a top-down, globally integrated approach to enterprise-wide risk management, and should be able to adapt their risk management structures to fit their particular mix of activities and risks. Under our approach, an FBO would have the flexibility to locate its risk management function where it would be most relevant to the FBO's particular mix of activities and circumstances, both geographically and organizationally. In some cases, it may be more appropriate for an FBO's U.S. risk management function to be housed in one of the FBO's subsidiaries, depending on the FBO's mix of U.S. activities.

Under our proposed approach, an FBO could designate a management committee or other independent risk management function with responsibility for U.S. risk management to serve as the "U.S. risk committee" required by the Board, so long as the body is identified to the Board as serving that function.³⁵¹ Alternatively, an FBO could indicate that its enterprise-wide risk committee or other preexisting governance body is the responsible body for oversight of U.S. risk management as part of its broader duties.³⁵²

³⁵¹ The Board could require a specific delegation of U.S. risk management responsibility by the board of directors of an FBO or its IHC before accepting a management or employee committee or function as the "U.S. risk committee" required under the Proposal.

³⁵² An FBO should not be required to formally and separately set forth (in a charter, bylaws, terms of reference, etc.) that its risk committee or risk management function is responsible for U.S. risk management, so long as the United States is clearly part of its area of responsibility.

The Proposal's requirement that an FBO that operates in the U.S. solely through an IHC must locate its U.S. risk committee as a committee of the IHC's board of directors is also unduly prescriptive. We see no reason why the Board should impose a more restrictive requirement on FBOs that only have IHCs as compared to FBOs that have IHCs and U.S. branches. In both cases a body outside of the IHC's board of directors with appropriate management responsibility—whether it be the FBO's global risk management committee or some other body—could serve the same risk management function.

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(b) The Board Should Defer to Home Country Judgments regarding Appropriate Independence and Expertise Requirements

We appreciate the importance of independence and expertise in an institution's risk management function. Given the diversity of governance structures and home country requirements, however, we believe the Board should generally defer to home country judgments regarding the independence and experience necessary to carry out an FBO's risk management function, rather than imposing specific requirements for expertise or independence based on U.S. corporate governance and management traditions.

Not all FBOs come from jurisdictions with similar independence criteria for directors (and, as discussed above, it would not always be the case that a committee of a board of directors would be the appropriate body to oversee U.S. risk). Rather than focusing on an understanding of director independence grounded in U.S. public company concepts, the Board should accept that a board of directors supervised by a competent regulator has the ultimate oversight responsibility for all aspects of an FBO's business, including risk management, and instead focus on the independence of the risk management function. The key attribute of effective risk oversight is not necessarily independence from the firm as a whole, but rather independence from the business lines that are the subject of oversight.³⁵³

Likewise, while we fully support the principle that an FBO's risk committee and risk management function must have an understanding of and experience in applying risk management practices and procedures appropriate to the size, mix and complexity of the FBO's operations, we encourage the Board to defer to home country judgments regarding whether an FBO has the appropriate expertise in key risk management roles. The Board should look to home country qualifications and Basel principles to establish the necessary scope and level of expertise rather than impose potentially duplicative or inconsistent U.S.-specific requirements that could distract from enterprise-wide risk management.

(c) Scope of Board Supervisory Authority and Access to Information

By advocating that the Board generally take a more deferential approach to an FBO's home country supervisory requirements and risk management governance structures, we do not mean to suggest that the Board should reduce its separate role and responsibility to supervise the risk management of FBOs' U.S. operations. Instead, we encourage the Board to build upon its traditional approach to FBO supervision and monitor the risk management practices of FBOs' U.S. operations as part of its regular supervisory and examination activities, with an increased focus on aspects of risk management relevant to systemic risk.

³⁵³ See, e.g., Basel Committee, Principles for Enhancing Corporate Governance (“[T]he risk management function should be sufficiently independent of the business units whose activities and exposures it reviews. While such independence is an essential component of an effective risk management function, it is also important that risk managers are not so isolated from business lines—geographically or otherwise—that they cannot understand the business or access necessary information. Moreover, the risk management function should have access to all business lines that have the potential to generate material risk to the bank. Regardless of any responsibilities that the risk management function may have to business lines and senior management, its ultimate responsibility should be to the board.”)

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We also encourage the Board to work closely with home country regulators in its supervision of an FBO's risk management, because home country supervisors will have a more direct window into the FBO's enterprise-wide risk management. To the extent the Board and home country regulator cannot agree on appropriate risk management measures for a particular FBO that presents a potential systemic risk to the United States, the Board's enhanced authority to address systemic risk under Section 165 would provide the Board with sufficient authority to address perceived weaknesses in the FBO's U.S. risk management on a case-by-case basis.

The Proposal notes that the Board is concerned about the ability of FBOs to produce, and the Board to understand, information about the risk profile of an FBO's U.S. operations on a timely basis. In our view, categorical requirements to create a particular governance structure, especially without consideration of the actual systemic risks that an FBO might pose to U.S. financial stability, will not address this concern. The Board already has experience examining the risk management practices of all FBOs operating in the United States as part of its regular supervisory and examination activities. Although we understand that the Board may desire to augment these practices to address concerns about inadequate or untimely information regarding an FBO's U.S. operations, we believe these preexisting approaches, combined with tailored information reporting requirements and better cooperation with home country regulators, would better address the Board's informational concerns. To the extent the Board does not believe it is getting enough information or other cooperation from an FBO or its regulators, the potential application of additional, more prescriptive regulatory requirements should provide ample incentives for cooperation.

(d) The Board Should Not Impose a Formal U.S. Chief Risk Officer Requirement

Many SI-FBOs and other FBOs with substantial U.S. operations have a U.S. CRO as part of their U.S. risk management structure. However, in our view the proposed U.S. CRO requirement is overly prescriptive and unnecessary to address the Board's mandate under Section 165. While we appreciate the value in having a single officer responsible for supervising the risk management practices of the FBO's combined U.S. operations and serving as a "liaison" to the Board with respect to those practices, the most appropriate remit and reporting structure for this officer will vary depending on the specific profile of an FBO's U.S. activities and the overall enterprise-wide risk management framework of the FBO. So long as an FBO is able to identify an officer inside the organization to serve as the point of contact for the Board regarding U.S. risk management practices, and that individual is of sufficient stature and seniority within the organization to speak authoritatively on matters of U.S. risk management, the Board's supervisory concerns should be addressed.³⁵⁴

As one example, it may be that the FBO's U.S. activities primarily consist of investment banking activities, such that the global investment banking CRO, or a direct report to the global investment banking CRO, is the most appropriate officer to adopt the role of U.S.

³⁵⁴ Indeed, we note that the Board's decision to propose a U.S. CRO requirement is wholly a matter of supervisory discretion, since there is no specific requirement for a CRO (either U.S. or global) in Section 165. There is no legal requirement for this particular approach if an FBO can satisfy the Board's concerns in a different manner.

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CRO. In other cases, it could be that an FBO's U.S. and non-U.S. activities are sufficiently integrated that it would be most logical for a non-U.S. employee of the FBO to serve as the primary point of contact on U.S. risk management matters.³⁵⁵

B. The Proposal's Liquidity Risk Management Requirements Should also Be More Flexible to Accommodate a Range of Effective Enterprise-Wide Liquidity Risk Management Functions

As noted above, we support the Board's focus on enhanced liquidity risk management, and concede that liquidity risk management systems were underdeveloped prior to the financial crisis. And we acknowledge that global and U.S. liquidity must be better monitored and more transparent to regulators and management. In many ways, the Board's proposed framework for liquidity risk management is consistent with efforts already undertaken by internationally active banks. We are concerned, however, that the Proposal's liquidity risk management framework for FBOs with \$50 billion or more in U.S. assets lacks sufficient flexibility to accommodate the full range of effective approaches to liquidity risk management.

In lieu of the more prescriptive elements of the U.S. liquidity risk management framework described in the Proposal, we would suggest that the Board articulate the guiding principles and expectations that FBOs should take into account in designing the liquidity risk management function that covers an FBO's U.S. operations. Principles such as independence from personnel executing transactions for the treasury function, strong governance and internal controls, and special focus on internal and external cash flow should not be controversial and are consistent with FBOs' own priorities for designing an effective risk management function. The Board would of course retain the authority to supervise and examine the structures FBOs use for a liquidity risk management function, and identify any perceived deficiencies with an expectation that they be addressed by the FBO.

C. Deficiencies and Noncompliance with Risk Management Requirements Should Not Be Addressed through Early Remediation

Under the Proposal, the Board could activate early remediation triggers for FBOs that demonstrate "signs of weakness", "multiple deficiencies" or "substantial noncompliance" with risk management requirements. We would hope and expect that the Board will primarily rely on supervisory processes and cross-border supervisory cooperation to address deficiencies and noncompliance with risk management requirements. Using automatic early remediation measures to address risk management compliance would rarely be appropriate, given the adverse consequences and significant costs associated with the early remediation triggers.

³⁵⁵ There should be no requirement in the final rule that the U.S. CRO must be an employee of a U.S. entity, so long as the duties and responsibilities of the relevant CRO are sufficient to address the Board's expectations for a U.S. CRO in that circumstance (and so long as the Board has an effective U.S.-based point of contact, which we expect the Board would always have in the ordinary course of its supervision of major FBOs).

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VIII. Effective Dates and Implementation Timing

A. Timing of Generally Applicable Effective Date and Availability of Extensions

We support the Board's proposed deferral of the effective date of the Proposal, but we would suggest three changes to the proposed effective date:

- First, it appears that the July 1, 2015 effective date in the Proposal likely assumed that the effective date would fall approximately two years after adoption of a final rule implementing Section 165 for FBOs. (We also recognize that July 1, 2015 aligns approximately with the effective date of the Collins Amendment.) However, because we anticipate that it will take more than two months after the close of the comment period for the Board to finalize the Proposal, and especially because we are requesting that the Board issue a new proposal more in line with the suggestions in our comments, we would suggest that the Board key the effective date off of the date of its adoption of a final rule. This would help ensure that affected FBOs will have a minimum amount of time after adoption of a final rule to come into compliance.
- Second, if the basic substantive approaches of the Proposal are retained in the final rule, then in view of the potentially enormous structural and operational changes that would be required for many FBOs we would respectfully suggest that the effective date be set at three years from the date of the final rule, rather than the implicit two year delayed effective date in the Proposal. In connection with extending the effective date to three years from the adoption of the final rule, we think it would be reasonable for the Board to examine institutions in the third year before the effective date for evidence of good faith efforts and progress toward coming into compliance, recognizing that actual compliance would not be required until the effective date.
- Third, the effective date should be aligned with the end of an FBO's fiscal year, to allow FBOs to manage revisions to their structures and operations and the financial implications of the new requirements in connection with year-end business planning.

Combining these three suggestions would mean revising the proposed effective date to be the end of the FBO's fiscal year that is at least three years from the date of the Board's adoption of a final rule.

We also support the Board's inclusion of potential extensions of effective dates in the Proposal. FBOs should be able to apply to the Board for extensions of particular requirements or all of the requirements under appropriate circumstances.

B. Timing of Effective Date for FBOs that Cross Relevant Thresholds later than One Year before the Generally Applicable Effective Date

For most of the Proposal's requirements, if an FBO crosses the relevant asset threshold later than one year before the effective date of the Board's final rule, the requirements would become effective one year after the FBO crosses the threshold (unless the time period is

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accelerated or extended in writing by the Board). We would strongly urge the Board to extend this conformance period to two years, and to confirm that the conformance period would be accelerated only in unusual circumstances when the FBO presented a significant threat to U.S. financial stability that required such an acceleration. One year is too short a time period to expect an FBO to undertake many of the actions that would be required in the Proposal, especially actions that would require restructuring of U.S. operations.

In recent years, many FBOs have seen declining U.S. assets, suggesting that few will be crossing the thresholds in the short term. At the same time, several FBOs are currently close to, but under, the proposed thresholds. The Board, other U.S. policymakers, and U.S. customers and counterparties should all hope that FBOs increase their participation in U.S. markets and grow their U.S. assets in the medium term in support of a U.S. economic recovery. The inherent cliff effects associated with the proposed asset thresholds will cause FBOs below the thresholds to attempt to manage below them or make the conscious choice to cross them, but the timing of crossing a set threshold cannot be predicted with certainty. While we support the Board's inclusion of a rolling four-quarter look-back to test whether an FBO crosses the relevant thresholds, in many cases there will still remain uncertainty until the fourth quarter of the look-back period whether the threshold will be crossed. FBOs are unlikely to invest significant resources or commence restructuring transactions to anticipate compliance with the Board's final rule until they are certain the threshold actually will be crossed. Consequently, FBOs that do cross the threshold should be given a reasonable period of time to come into conformance with the applicable requirements (in our view, two years).

C. An Iterative Approach to Key Elements of the Proposal

Especially if the Board were to retain the more radical elements of the Proposal in a final rule, we would urge the Board to take an iterative approach to implementation. Requirements such as U.S.-specific stress testing, IHC capital planning, liquidity stress testing, etc. for purposes of meeting U.S. regulatory requirements (as opposed to internal risk management and planning) are likely to require significant investments in systems, personnel and expertise by FBOs subject to those requirements. So long as FBOs are making meaningful progress to implement the new requirements and adhering to the rule's requirements in a good faith manner, FBOs should not be penalized for shortcomings that do not present risks to U.S. financial stability.

In our view, the Board's explanations of the Proposal have unduly minimized the drastic nature of its departure from settled U.S. policies and approaches to supervising and regulating cross-border financial services activities of FBOs. If the Board's final rule contains many of the fundamental features of the Proposal, it will be critical to give FBOs an opportunity to adjust to the new regime without undue disruption. The Board should also take into account that implementation of many of these requirements, which would diverge from home country approaches, will overlap from a timing perspective with FBOs' substantial dedication of resources to implement new home country standards globally.

In short, the more radically the final rule departs from existing Board policies and supervisory standards, the more important it will be to avoid punitive approaches to enforcing compliance with the new regime.

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Appendix: Questions Asked by the Board in the Proposal

Foreign Nonbank SIFIs

Question 1: Should the Board require a foreign nonbank financial company supervised by the Board to establish a U.S. intermediate holding company? Why or why not? What activities, operations, or subsidiaries should the foreign nonbank financial company be required to conduct or hold under the U.S. intermediate holding company?

As discussed at length in Part I, the IIB believes that the IHC requirement is unnecessary and overbroad, inconsistent with the Board's statutory mandate, potentially harmful to economic growth and should be abandoned in favor of a tailored approach to regulation of SI-FBOs. Although our comments focus on the application of the Section 165 Standards to FBOs, we believe many of our concerns regarding the Proposal's IHC requirement for FBOs, discussed in Part I of our comments, would also apply with respect to nonbank financial companies designated by the FSOC under Dodd-Frank Section 113 for regulation by the Board under Section 165 ("nonbank SIFIs").

Question 2: If the Board required a foreign nonbank financial company supervised by the Board to form a U.S. intermediate holding company, how should the Board modify the manner in which the enhanced prudential standards and early remediation requirements would apply to the U.S. intermediate holding company, if at all? What specific characteristics of a foreign nonbank financial company should the Board consider when determining how to apply the enhanced prudential standards and the early remediation requirements to such a company?

The IIB reserves comment on what form the Section 165 Standards should take with respect to foreign nonbank SIFIs until the Board proposes their specific application to a particular company or set of companies. As described at length in our comments, we believe the Proposal takes too categorical an approach to regulating FBOs through IHCs, and that the Section 165 Standards should be applied to SI-FBOs and foreign nonbank SIFIs on a tailored basis. Specifically, the Board should take into consideration that our discussion of the capital adequacy of U.S. registered broker dealer subsidiaries of SI-FBOs in Part I.A.9.f of our comments also applies to subsidiaries of foreign nonbank financial companies that are U.S. nonbank financial companies subject to supervision and regulation by the SEC and FINRA. Whether these parent foreign nonbank financial companies are subject to consolidated and comprehensive supervision by their home country regulators should be given considerable weight in the analysis. See Part I.B of our comments for a description of our proposed alternative to the IHC requirement, the "the SI-FBO Framework". See also Part I of our comments for a discussion of the IHC requirement and Parts II to VII for specific suggestions on how to modify specific Section 165 Standards for application to an IHC.

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Timing of Application

Question 3: Does the proposal effectively promote the policy goals stated in this preamble and help mitigate the challenges with cross-border supervision discussed above? Do any aspects of the policy create undue burden for supervised institutions?

Responses to these questions are included in Part I.A of our comments.

Question 4: What challenges are associated with the proposed phase-in schedule?

See Part VIII of our comments.

Question 5: What other considerations should the Board address in developing any phase-in of the proposed requirements?

See Part VIII of our comments.

IHC Requirement

Question 6: What opportunities for regulatory arbitrage exist within the proposed framework, if any? What additional requirements should the Board consider applying to a U.S. branch and agency network to ensure that U.S. branch and agency networks do not receive favorable treatment under the enhanced prudential standards regime?

We would respectfully take exception to the premise of this question, since FBO structural choices do not necessarily involve “regulatory arbitrage,” and there will be legitimate and, from a policy perspective, appropriate reasons for conducting activities through U.S. branches to maximize efficiency. Regulatory requirements applicable to an FBO in the jurisdictions where it conducts business are only one of many factors that an FBO considers when making judgments about the appropriate structure for its activities and business strategy, and in the past FBOs have come to different decisions about what structure is preferable. In addition, there are several other U.S. and non-U.S. regulatory requirements under continuing development—such as swaps push out, implementation of Title VII of Dodd-Frank and home country implementation Basel III—which could factor into measuring the efficiency of different structures for conducting U.S. banking and other financial activities.

The IHC requirement and associated IHC capital requirements in particular would most likely make activities conducted through U.S. subsidiaries relatively more expensive than the same activities conducted through a U.S. branch or a non-U.S. affiliate or office (assuming that the activities in question can permissibly be conducted through a U.S. branch or non-U.S. subsidiary or office). As a result, the Proposal could affect an FBO’s choices regarding structure and location of activities. We note that the SI-FBO Framework described in Part I.B of our comments, which would take a tailored approach to application of the Section 165 Standards focused on the actual systemic risks posed by each institution and/or its specific activities, would minimize the extent to which measures such as the IHC requirement would affect structural choices for FBOs generally. See also Parts I – IV of our comments.

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Question 7: Should the Board consider an alternative asset threshold for purposes of identifying the companies required to form a U.S. intermediate holding company, and if so, what alternative threshold should be considered and why? What other methodologies for calculating a company's total U.S. assets would better serve the purposes of the proposal?

See Parts I.C.1 and I.D of our comments.

Question 8: Should the Board provide an exclusive list of exemptions to the intermediate holding company requirement or provide exceptions on a case-by-case basis?

See Part I.C of our comments for our discussion of the scope of the IHC requirement and our suggested exemptions.

Question 9: Is the definition of U.S. subsidiary appropriate for purposes of determining which entities should be held under the U.S. intermediate holding company?

No. See Parts I.C.2.a – c of our comments.

Question 10: Should the Board consider exempting any other categories of companies from the requirement to be held under the U.S. intermediate holding company, such as controlling investments in U.S. subsidiaries made by foreign investment vehicles that make a majority of their investments outside of the United States, and if so, which categories of companies?

Yes. See Part I.C of our comments.

Question 11: What, if any, tax consequences, international or otherwise, could present challenges to a foreign banking organization seeking to (1) reorganize its U.S. subsidiaries under a U.S. intermediate holding company and (2) operate on an ongoing basis in the United States through a U.S. intermediate holding company that meets the corporate form requirements described in the proposal?

See Part I.A.5.g of our comments.

Question 12: What other costs would be associated with forming a U.S. intermediate holding company? Please be specific and describe accounting or other operating costs.

See Part I.A.5.c of our comments.

Question 13: What impediments in home country law exist that could prohibit or limit the formation of a single U.S. intermediate holding company?

See Part I.C. of our comments.

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Question 14: Should the Board adopt an alternative process in addition to, or in lieu of, the post-notice procedure described above?³⁶⁶ For example, should the Board require a before-the-fact application? Why or why not?

The SI-FBO Framework would involve an entirely different procedure for the Board and a SI-FBO to consider the potential utility of an IHC on a tailored, discretionary basis. See Part I.B of our comments. To the extent the Board were to retain an IHC requirement as an across-the-board requirement for any category of FBOs, an after-the-fact procedure should be sufficient, recognizing that many FBOs will also pursue whatever procedure the Board establishes to consider requests for exceptions and adjustments to the IHC requirement based on their individual circumstances and the structure of their U.S. subsidiaries.

Risk-based Capital and Leverage Requirements

Question 15: Are there provisions in the Board's Basel III proposals that would be inappropriate to apply to U.S. intermediate holding companies?

Yes. See Part II.B of our comments.

Question 16: In what ways, if any, should the Board consider modifying the requirements of the capital plan rule as it would apply to U.S. intermediate holding companies? For example, would the capital policy of a U.S. intermediate holding company of a foreign banking organization differ meaningfully from the capital policy of a U.S. bank holding company?

See Part II.B.6 of our comments.

Question 17: What challenges would foreign banking organizations face in complying with the proposed enhanced capital standards framework described above? What alternatives should the Board consider? Provide detailed descriptions for alternatives.

See Parts I and II of our comments.

³⁶⁶ See 77 Fed. Reg. at 76,639 (“Notice Requirements. To reduce burden on foreign banking organizations, the Board proposes to adopt an after-the-fact notice procedure for the formation of a U.S. intermediate holding company and the changes in corporate structure required by this proposal. Under the proposal, within 30 days of establishing a U.S. intermediate holding company, a foreign banking organization would be required to provide to the Board: (1) A description of the U.S. intermediate holding company, including its name, location, corporate form, and organizational structure, (2) a certification that the U.S. intermediate holding company meets the requirements of this section, and (3) any other information that the Board determines is appropriate.”)

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Question 18: What concerns, if any, are raised by the proposed requirement that a foreign banking organization calculate regulatory capital ratios in accordance with home country rules that are consistent with the Basel Accord, as amended from time to time? How might the Federal Reserve refine the proposed requirements to address those concerns?

See Part II.A of our comments.

Question 19: Should the Board require a foreign banking organization to meet the current minimum U.S. leverage ratio of 4 percent on a consolidated basis in advance of the 2018 implementation of the international leverage ratio? Why or why not?

No. See Part II.A.3 of our comments.

Liquidity Requirements

Question 20: Is the Board's approach to enhanced liquidity standards for foreign banking organizations with significant U.S. operations appropriate? Why or why not?

See Part III of our comments.

Question 21: Are there other approaches that would more effectively enhance liquidity standards for these companies? If so, provide detailed examples and explanations.

See Part III of our comments.

Question 22: The Dodd-Frank Act contemplates additional enhanced prudential standards, including a limit on short-term debt. Should the Board adopt a short-term debt limit in addition to, or in place of, the Basel III liquidity requirements in the future? Why or why not?

No. To the extent the Board's concerns about systemic risks arising from an FBO's use of short-term debt are not addressed by Basel III liquidity requirements, the Board should address its concerns on a case-by-case basis. A blanket requirement would be overbroad and inappropriate. See also Parts I.A – B and Part III of our comments.

Question 23: Should foreign banking organizations with a large U.S. presence be required to provide cash flow statements for all activities they conduct in U.S. dollars, whether or not through the U.S. operations? Why or why not?

The Board should not impose a blanket reporting obligation on all FBOs, but could waive or modify other requirements otherwise applicable to an FBO depending on the extensiveness of information the FBO reports to the Board on activities relevant to U.S. financial stability, which in some cases might include cash flow statements for all activities the FBO conducts in U.S. dollars. See Part III.B.3.a.

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Question 24: What challenges will foreign banking organizations face in formulating and implementing liquidity stress testing described in the proposed rule? What changes, if any, should be made to the proposed liquidity stress testing requirements (including the stress scenario requirements) to ensure that analyses of the stress testing will provide useful information for the management of a company's liquidity risk? What alternatives to the proposed liquidity stress testing requirements, including the stress scenario requirements, should the Board consider? What additional parameters for the liquidity stress tests should the Board consider defining?

The design and implementation of liquidity stress testing will be a critical factor in determining the ultimate impact of the liquidity buffer requirement on FBOs. As we discuss in Part III.A of our comments, the Board should generally defer to an FBO's implementation of home country liquidity stress testing requirements on a consolidated basis, as applied to the FBO's U.S. operations, consistent with the stress testing principles set forth in the Basel Committee's principles for liquidity risk management.

Question 25: The Board requests feedback on the proposed approach to intragroup flows as well as the described alternatives. What are the advantages and disadvantages of the alternatives versus the treatment in the proposal? Are there additional alternative approaches to intracompany cash flows that the Board should consider? Provide detailed answers and supporting data where available.

See Parts III.B.1 – 3 of our comments.

Question 26: Should U.S. branch and agency networks be required to cover net internal stressed cash flow needs for days 15 to 30 of the required stress scenario within the United States? Should U.S. branch and agency networks be required to hold the entire 30-day liquidity buffer in the United States?

Although we are not sure we understand the distinction between these two questions, we discuss the location requirements relating to the Proposal's liquidity buffer in Part III.B.3.j of our comments.

Question 27: The Board requests comment on all aspects of the proposed definitions of highly liquid assets and unencumbered. What, if any, other assets should be specifically listed in the definition of highly liquid assets? Why should these other assets be included? Are the criteria for identifying additional assets for inclusion in the definition of highly liquid assets appropriate? If not, how and why should the Board revise the criteria?

See Parts III.B.3.e, h – f and k of our comments.

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Question 28: Should the Board require matching of liquidity risk and the liquidity buffer at the individual branch level rather than allowing the firm to consolidate across U.S. branch and agency networks? Why or why not?

No. Requiring liquidity buffers to be held at the individual branch level would further fragment liquidity and would be especially inappropriate as applied to different U.S. offices of a single legal entity. See Part III.B.2 of our comments.

Question 29: Should U.S. intermediate holding companies be allowed to deposit cash portions of their liquidity buffer with affiliated branches or U.S. entities? Why or why not?

Yes. See Part III.B.3.j of our comments.

Question 30: In what circumstances should the cash portion of the liquidity buffer be permitted to be held in a currency other than U.S. dollars?

See Part III.B.3.i of our comments.

Question 31: Should the Board provide more clarity around when the liquidity buffer would be allowed to be used to meet liquidity needs during times of stress? What standards would be appropriate for usage of the liquidity buffer?

As an initial matter, the Board should clarify that the liquidity buffer can be used in times of stress, which is implicit in the Board's question but not clear in the Proposal. See Part III.B.3.1 of our comments. Beyond that clarification, we do not believe it would be necessary or appropriate to articulate the standards or criteria for use of the liquidity buffer in stress scenarios.

Question 32: Are there situations in which compliance with the proposed rule would hinder a foreign banking organization from employing appropriate liquidity risk management practices? Provide specific detail.

Yes. See Part III.B.2.d and Part VII.B of our comments.

Question 33: Should foreign banking organizations with a large U.S. presence be required to establish and maintain limits on other potential sources of liquidity risk in addition to the specific sources listed in the proposed rule? If so, identify these additional sources of liquidity risk.

The Board should defer to comparable home country liquidity standards regarding the specific requirements for liquidity management and controls applicable to an FBO. See Parts III and VII of our comments.

Question 34: The Board requests comment on all aspects of the proposed rule. Specifically, what aspects of the proposed rule present implementation challenges and why? What alternative approaches to liquidity risk management should the Board consider? Are the liquidity management requirements of this proposal too specific or too narrowly defined? If, so explain how. Responses should be detailed as to the nature and effect of these challenges and should address

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whether the Board should consider implementing transitional arrangements in the proposal to address these challenges.

See Part III of our comments.

Single-Counterparty Credit Limit

Question 35: What challenges would a foreign banking organization face in implementing the requirement that all subsidiaries of the U.S. intermediate holding company and any part of the combined U.S. operations are subject to the proposed single-counterparty credit limit?

See Part IV of our comments.

Question 36: Because a foreign banking organization may have strong incentives to provide support in times of distress to certain U.S.-based funds or vehicles that it sponsors or advises, the Board seeks comment on whether such funds or vehicles should be included as part of the U.S. intermediate holding company or the combined U.S. operations of the foreign banking organization for purposes of this rule.

No. See Joint Trade Associations Letter.

Question 37: How should exposures to SPVs and their underlying assets and sponsors be treated? What other alternatives should the Board consider?

See Joint Trade Associations Letter.

Question 38: Should the definition of “counterparty” differentiate between types of exposures to a foreign sovereign entity, including exposures to local governments? Should exposures to a company controlled by a foreign sovereign entity be included in the exposure to that foreign sovereign entity?

See Part IV.I.1 – 2 of our comments. See also Joint Trade Associations Letter.

Question 39: What additional credit exposures to foreign sovereign entities should be exempted from the limitations of the proposed rule?

See Part IV.I.1 – 2 of our comments. See also Joint Trade Associations Letter.

Question 40: What other alternatives to the proposed definitions of capital stock and surplus should the Board consider?

See Part IV.I.4 of our comments.

Question 41: Should the Board adopt a more nuanced approach, like the BCBS approach, in determining which foreign banking organizations and U.S. intermediate holding companies would be treated as major foreign banking organizations or major

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U.S. intermediate holding companies or which counterparties should be considered major counterparties?

See Part IV.H of our comments.

Question 42: Should the Board introduce more granular categories of foreign banking organizations or U.S. intermediate holding companies to determine the appropriate credit exposure limit? If so, how could such granularity best be accomplished?

See Part IV.F and Parts IV.G.1 – 2 of our comments.

Question 43: The Board seeks comment on all aspects of the valuation methodologies included in the proposed rule.

See Joint Trade Associations Letter.

Question 44: The Board requests comment on whether the proposed scope of the attribution rule is appropriate or whether additional regulatory clarity around the attribution rule would be appropriate. What alternative approaches to applying the attribution rule should the Board consider? What is the potential cost or burden of applying the attribution rule as described above?

See Part IV.I.5.c of our comments. See also Joint Trade Associations Letter.

Question 45: Should the list of eligible collateral be broadened or narrowed? Should a covered entity be able to use its own internal estimates for collateral haircuts as permitted under Appendix G to Regulation Y?

See Part IV.G.3.b of our comments. See also Joint Trade Associations Letter.

Question 46: Is recognizing the fluctuations in the value of eligible collateral appropriate?

See Joint Trade Associations Letter.

Question 47: What is the burden associated with the proposed rule's approach to changes in the eligibility of collateral?

See Joint Trade Associations Letter.

Question 48: Is the approach to eligible collateral that allows the covered entity to choose whether or not to recognize eligible collateral and shift credit exposure to the issuer of eligible collateral appropriate?

See Joint Trade Associations Letter.

Question 49: What alternative approaches, if any, to the proposed treatment of the unused portion of certain credit facilities should the Board consider?

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The IIB has no specific suggestions at this time.

Question 50: Are there any additional or alternative requirements the Board should place on eligible protection providers to ensure their capacity to perform on their guarantee obligations?

See Part IV.G.3.b of our comments.

Question 51: Should a covered entity have the choice of whether or not to fully shift exposures to eligible protection providers in the case of eligible guarantees or to divide an exposure between the original counterparty and the eligible protection provider in some manner?

See Joint Trade Associations Letter.

Question 52: What types of derivatives should be eligible for mitigating gross credit exposure?

The IIB has no specific suggestions at this time.

Question 53: What alternative approaches, if any, should the Board consider to capture the risk mitigation benefits of proxy or portfolio hedges or to permit U.S. intermediate holding companies or any part of the combined U.S. operations to use internal models to measure potential exposures to sellers of credit protection?

See Joint Trade Associations Letter.

Question 54: Would a more conservative approach to eligible credit or equity derivative hedges be more appropriate, such as one in which the U.S. intermediate holding company or any part of the combined U.S. operations would be required to recognize gross notional credit exposure both to the original counterparty and the eligible protection provider?

See Joint Trade Associations Letter.

Question 55: What temporary exceptions should the Board consider, if any?

The Board should take a phased, iterative approach to application of the Section 165 Standards, including the SCCL. See generally Part VIII of our comments.

Question 56: Would additional exemptions for foreign banking organizations be appropriate? Why or why not?

See Parts IV.F – I of our comments.

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Risk Management

Question 57: Should the Board require that a company's certification under section 252.251 of the proposal include a certification that at least one member of the U.S. risk committee satisfies director independence requirements? Why or why not?

No. See Part VII.A.4.b of our comments.

Question 58: Should the Board consider requiring that all U.S. risk committees required under the proposal not be housed within another committee or be part of a joint committee, or limit the other functions that the U.S. risk committee may perform? Why or why not?

No. See Part VII.A.4 of our comments.

Question 59: As an alternative to the proposed U.S. risk committee requirement, should the Board consider requiring each foreign banking organization with combined U.S. assets of \$50 billion or more to establish a risk management function solely in the United States, rather than permitting the U.S. risk management function to be located in the company's home office? Why or why not? If so, how should such a function be structured?

No. See Part VII.A.4 of our comments.

Question 60: Should the Board consider requiring or allowing a foreign banking organization to establish a "U.S. risk management function" that is based in the United States but not associated with a board of directors to oversee the risk management practices of the company's combined U.S. operations? What are the benefits and drawbacks of such an approach?

Yes. See Part VII.A.4 of our comments.

Question 61: Should the Board consider allowing a foreign banking organization with combined U.S. assets of \$50 billion or more that has a U.S. intermediate holding company subsidiary and operates no branches or agencies in the United States the option to comply with the proposal by maintaining a U.S. risk committee of the company's global board of directors? Why or why not?

Yes. See Part VII.A.4.a of our comments.

Question 62: Is the scope of review of the risk management practices of the combined U.S. operations of a foreign banking organization appropriate? Why or why not?

See Part VII of our comments.

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Question 63: What unique ownership structures of foreign banking organizations would present challenges for such companies to comply with the requirements of the proposal? Should the Board incorporate flexibility for companies with unique or nontraditional ownership structures into the rule, such as more than one top-tier company? If so, how?

See Part VII of our comments.

Question 64: Is it appropriate to require the U.S. risk committee of a foreign banking organization to meet at least quarterly? If not, what alternative requirement should be considered and why?

No. See Part VII.A.4 of our comments.

Question 65: Should the Board require that a member of the U.S. risk committee comply with the director independence standards? Why or why not?

No. See Part VII.A.4.b of our comments.

Question 66: Should the Board consider specifying alternative or additional qualifications for director independence? If so, describe the alternative or additional qualifications. Should the Board require that the chair of a U.S. risk committee satisfy the director independence standards, similar to the requirements in the December 2011 proposal for large U.S. bank holding companies?

No. See Part VII.A.4.b of our comments.

Question 67: Would it be appropriate for the Board to permit the U.S. chief risk officer to fulfill other responsibilities, including with respect to the enterprise-wide risk management of the company, in addition to the responsibilities of section 252.253 of this proposal? Why or why not?

Yes. See Part VII.A.4 of our comments.

Question 68: What are the challenges associated with the U.S. chief risk officer being employed by a U.S. entity?

See Part VII.A.4.d of our comments.

Question 69: Should the Board consider approving alternative reporting structures for a U.S. chief risk officer on a case-by-case basis if the company demonstrates that the proposed reporting requirements would create an exceptional hardship or under other circumstances?

Although we appreciate the Board's consideration of whether to accommodate different management and reporting structures, in our view flexibility should be permitted without prior notice or approval. See Part VII.A of our comments. Otherwise we would agree that the Board should consider requests for adjustments on a case-by-case basis.

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Question 70: Should the Board consider specifying by regulation the minimum qualifications, including educational attainment and professional experience, for a U.S. chief risk officer?

No. See Part VII.A.4.b of our comments.

Question 71: What alternative responsibilities for the U.S. chief risk officer should the Board consider?

See Part VII.A.4.d of our comments.

Question 72: Should the Board require each foreign banking organization with total consolidated assets of \$50 billion or more and combined U.S. assets of less than \$50 billion to designate an employee to serve as a liaison to the Board regarding the risk management practices of the company's combined U.S. operations? A liaison of this sort would meet annually, and as needed, with the appropriate supervisory authorities at the Board and be responsible for explaining the risk management oversight and controls of the foreign banking organization's combined U.S. operations. Would these requirements be appropriate? Why or why not?

We would support a requirement that all FBOs, both above and below \$50 billion in U.S. assets, appoint an individual officer or employee to serve as the principal point of contact for the Board. In our view, FBOs with less than \$50 billion in U.S. assets should generally be exempted from the Proposal's requirements (because they do not present a systemic risk to the United States). However, the Board and FBOs in that category would retain flexibility to designate such a principal point of contact in the ordinary course of the Board's exercise of its supervisory authority over FBOs. See Parts VII.A.3 – 4 of our comments.

Stress Testing Requirements

Question 73: What other standards should the Board consider to determine whether a foreign banking organization's home country stress testing regime is broadly consistent with the capital stress testing requirements of the Dodd-Frank Act?

See Part V.A of our comments.

Question 74: Should the Board consider conducting supervisory loss estimates on the U.S. branch and agency networks of large foreign banking organizations by requiring U.S. branches and agencies to submit data similar to that required to be submitted by U.S. bank holding companies with total consolidated assets of \$50 billion or more on the FR Y-14? Alternatively, should the Board consider requiring foreign banking organizations to conduct internal stress tests on their U.S. branch and agency networks?

See Part V.A.6 of our comments.

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Question 75: Should the Board consider alternative asset maintenance requirements, including definitions of eligible assets or liabilities under cover or the percentage?

It is essential that the Board consult and coordinate closely with the appropriate primary supervisory authority for a branch in advance of imposing any asset maintenance requirement and that any such requirement that might be imposed pursuant to Section 165 not conflict with requirements prescribed by the primary supervisory authority.

Question 76: Do the proposed asset maintenance requirement pose any conflict with any asset maintenance requirements imposed on a U.S. branch or agency by another regulatory authority, such as the FDIC or the OCC?

See our response to Question 75.

Question 77: What alternative standards should the Board consider for foreign banking organizations that do not have a U.S. intermediate holding company and are not subject to broadly consistent stress testing requirements? What types of challenges would the proposed stress testing regime present?

See Part V of our comments.

Question 78: Should the Board consider alternative prudential standards for U.S. operations of foreign banking organizations that are not subject to home country stress test requirements that are consistent with those applicable to U.S. banking organizations or do not meet the minimum standards set by their home country regulator?

Whether or not an FBO conducts home country consolidated stress testing should be one factor in evaluating whether the FBO presents a potential systemic risk to the United States that should be addressed by specific, targeted prudential standards under the SI-FBO Framework. See Part I.B and Part V of our comments.

Question 79: Should the Board consider providing a longer phase-in for foreign banking organizations with combined U.S. assets of less than \$50 billion?

See Parts V.A and B.4 of our comments. See also Part VIII of our comments.

Question 80: Is the proposed asset maintenance requirement calibrated appropriately to reflect the risks to U.S. financial stability posed by these companies?

See our response to Question 75.

Question 81: What alternative standards should the Board consider for foreign banking organizations that do not have a U.S. intermediate holding company and are not subject to consistent stress testing requirements? What types of challenges would the proposed stress testing regime present?

See our responses to Questions 77 and 78.

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Question 82: What alternatives to the definitions and procedural aspects of the proposed rule regarding a company that poses a grave threat to U.S. financial stability should the Board consider?

See Part VI.H of our comments.

Early Remediation

Question 83: Should the Board consider a level outside of the specified range [of capital-based triggers]? Why or why not?

See Part VI.C of our comments.

Question 84: The Board seeks comment on the proposed risk-based capital and leverage triggers. What is the appropriate level within the proposed ranges above and below minimum requirements that should be established for the triggers in a final rule? Provide support for your answer.

See Part VI.C of our comments.

Question 85: The Board seeks comment on how and to what extent the proposed risk-based capital and leverage triggers should be aligned with the capital conservation buffer of 250 basis points presented in the Basel III rule proposal.

See Part VI.C of our comments.

Question 86: What alternative or additional risk-based capital or leverage triggering events, if any, should the Board adopt? Provide a detailed explanation of such alternative triggering events with supporting data.

See Part VI.C of our comments.

Question 87: What additional factors should the Board consider when incorporating stress test results into the early remediation framework for foreign banking organizations? What alternative forward looking triggers should the Board consider in addition to or in lieu of stress test triggers?

See Part V and Part VI of our comments. See also Joint Trade Associations Letter.

Question 88: Is the severely adverse scenario appropriately incorporated as a triggering event? Why or why not?

See our response to Question 87.

Question 89: The Board seeks comment on triggers tied to risk management. Should the Board consider specific risk management triggers tied to particular events? If so, what might such triggers involve? How should failure to promptly address material risk management weaknesses be addressed by the early remediation regime?

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Under such circumstances, should companies be moved to progressively more stringent levels of remediation, or are other actions more appropriate? Provide a detailed explanation.

See Part VII.C of our comments.

Question 90: Should the Board include market indicators described in section G—Potential market indicators and potential trigger design of this preamble in the early remediation regime for the U.S. operations of foreign banking organizations? If not, what other market indicators or forward-looking indicators should the Board include?

See Part VI.E of our comments.

Question 91: How should the Board consider the liquidity of an underlying security when it chooses indicators for the U.S. operations of foreign banking organizations?

See Part VI.E of our comments.

Question 92: Should the Board consider using market indicators to move the U.S. operations of foreign banking organizations directly to level 2 (initial remediation)? If so, what time thresholds should be considered for such a trigger? What would be the drawbacks of such a second trigger?

See Part VI.E of our comments.

Question 93: To what extent do these indicators convey different information about the short-term and long-term performance of foreign banking organizations that should be taken into account for the supervisory review?

See Part VI.E of our comments.

Question 94: Should the Board use peer comparisons to trigger heightened supervisory review for foreign banking organizations? How should the peer group be defined for foreign banking organizations?

See Part VI.E of our comments.

Question 95: How should the Board account for overall market movements in order to isolate idiosyncratic risk of foreign banking organizations?

See Part VI.E of our comments.

Question 96: What additional monitoring requirements should the Board impose to ensure timely notification of trigger breaches?

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The Board should not impose any additional monitoring requirements. Its current supervisory approaches are sufficient to monitor potential breaches of remediation triggers. See also Part VI of our comment.

Question 97: Should the Board provide an exception to the prior approval requirement for de minimis acquisitions or other acquisitions in the ordinary course? If so, how would this exception be drafted in a narrow way so as not to subvert the intent of this restriction?

In general, we respectfully suggest in our comments that the Board should adopt a discretionary approach to application of remediation measures. See Part VI of our comments. However, the IIB would support an exemption for de minimis and ordinary course acquisitions when a remediation measure restricting acquisitions is applied, either as the result of a discretionary application of remediation measures or if the Board were to retain the mandatory application of measures in the final rule. A de minimis exception could be modeled on the types of exceptions granted from prior approval requirements imposed under Section 4(m) of the BHC Act, although the exception should also include a general exception for acquisitions of subsidiaries whose assets represent less than 5 percent of the FBO's combined U.S. assets, and non-controlling investments the consideration for which represents less than 1 percent of the FBO's combined U.S. assets. The Board would have broad supervisory and examination powers to monitor an FBO's compliance with any such restriction.

Question 98: The Board seeks comment on the proposed mandatory actions that would occur at each level of remediation. What, if any, additional or different restrictions should the Board impose on distressed foreign banking organizations or their U.S. operations?

In our view, the Board should adopt a discretionary approach to application of remediation measures (see Part VI of our comments), but otherwise there are not additional or different restrictions that we would suggest should be imposed as part of the Board's early remediation regime.

Question 99: The Board seeks comment on the proposed approach to market-based triggers detailed below, alternative specifications of market-based indicators, and the potential benefits and challenges of introducing additional market-based triggers for remediation levels 2, 3, or 4 of the proposal. In addition, the Board seeks comment on the sufficiency of information content in market-based indicators generally.

See Part VI.E of our comments.

Question 100: The Board is considering using both absolute levels and changes in indicators, as described in section G—Potential market indicators and potential trigger design. Over what period should changes be calculated?

See Part VI.E of our comments.

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Question 101: Should the Board use both time-variant and time-invariant indicators? What are the comparative advantages of using one or the other?

See Part VI.E of our comments.

Question 102: Is the proposed trigger time (when the median value over a period of 22 consecutive business days crosses the predetermined threshold) to trigger heightened supervisory review appropriate for foreign banking organizations? What periods should be considered and why?

See Part VI.E of our comments.

Question 103: Should the Board use a statistical threshold to trigger heightened supervisory review or some other framework?

See Part VI.E of our comments.